FINANCIAL RESEARCH PROGRAM OF THE
NATIONAL BUREAU OF ECONOMIC RESEARCH

Studies in Business Financing

GOVT GIRLS COLLEGE
SRINAGA
ACC. NO 4225
LIBRARY

NATIONAL BUREAU OF ECONOMIC RESEARCH

OFFICERS

W. Leonard Crum, *Chairman*
N. I. Stone, *President*
C. Reinold Noyes, *Vice-President*
Shepard Morgan, *Treasurer*
W. J. Carson, *Executive Director*
Martha Anderson, *Editor*

DIRECTORS AT LARGE

Chester I. Barnard, *President, New Jersey Bell Telephone Company*
David Friday, *Consulting Economist*
Oswald W. Knauth, *President, Associated Dry Goods Corporation*
H. W. Laidler, *Executive Director, League for Industrial Democracy*
Shepard Morgan, *Vice-President, Chase National Bank*
George E. Roberts, *Economic Adviser, National City Bank*
Beardsley Ruml, *Treasurer, R. H. Macy and Company*
Stanley Ruttenberg, *Economic Division, Congress of Industrial Organizations*
Harry Scherman, *President, Book-of-the-Month Club*
George Soule, *Director, The Labor Bureau, Inc.*
N. I. Stone, *Consulting Economist*

DIRECTORS BY UNIVERSITY APPOINTMENT

E. W. Bakke, *Yale*
C. Canby Balderston, *Pennsylvania*
W. Leonard Crum, *Harvard*
E. E. Day, *Cornell*
Guy Stanton Ford, *Minnesota*
H. M. Groves, *Wisconsin*
Clarence Heer, *North Carolina*
Wesley C. Mitchell, *Columbia*
T. O. Yntema, *Chicago*

DIRECTORS APPOINTED BY OTHER ORGANIZATIONS

Percival F. Brundage, *American Institute of Accountants*
Spencer Miller, Jr., *American Federation of Labor*
C. Reinold Noyes, *American Economic Association*
Winfield W. Riefler, *American Statistical Association*

RESEARCH STAFF

Wesley C. Mitchell, *Director*

Moses Abramovitz
Arthur F. Burns
Solomon Fabricant
Milton Friedman
Thor Hultgren
Simon Kuznets
Frederick C. Mills
Geoffrey H. Moore
Raymond J. Saulnier
Leo Wolman
Ralph A. Young

Relation of the Directors to the Work of the National Bureau of Economic Research

1. The object of the National Bureau of Economic Research is to ascertain and to present to the public important economic facts and their interpretation in a scientific and impartial manner. The Board of Directors is charged with the responsibility of ensuring that the work of the Bureau is carried on in strict conformity with this object.

2. To this end the Board of Directors shall appoint one or more Directors of Research.

3. The Director or Directors of Research shall submit to the members of the Board, or to its Executive Committee, for their formal adoption, all specific proposals concerning researches to be instituted.

4. No report shall be published until the Director or Directors of Research shall have submitted to the Board a summary drawing attention to the character of the data and their utilization in the report, the nature and treatment of the problems involved, the main conclusions and such other information as in their opinion would serve to determine the suitability of the report for publication in accordance with the principles of the Bureau.

5. A copy of any manuscript proposed for publication shall also be submitted to each member of the Board. For each manuscript to be so submitted a special committee shall be appointed by the President, or at his designation by the Executive Director, consisting of three Directors selected as nearly as may be one from each general division of the Board. The names of the special manuscript committee shall be stated to each Director when the summary and report described in paragraph (4) are sent him. It shall be the duty of each member of the committee to read the manuscript. If each member of the special committee signifies his approval within thirty days, the manuscript may be published. If each member of the special committee has not signified his approval within thirty days of the transmittal of the report and manuscript, the Director of Research shall then notify each member of the Board, requesting approval or disapproval of publication, and thirty additional days shall be granted for this purpose. The manuscript shall then not be published unless at least a majority of the entire Board and a two-thirds majority of those members of the Board who shall have voted on the proposal within the time fixed for the receipt of votes on the publication proposed shall have approved.

6. No manuscript may be published, though approved by each member of the special committee, until forty-five days have elapsed from the transmittal of the summary and report. The interval is allowed for the receipt of any memorandum of dissent or reservation, together with a brief statement of his reasons, that any member may wish to express; and such memorandum of dissent or reservation shall be published with the manuscript if he so desires. Publication does not, however, imply that each member of the Board has read the manuscript, or that either members of the Board in general, or of the special committee, have passed upon its validity in every detail.

7. A copy of this resolution shall, unless otherwise determined by the Board, be printed in each copy of every National Bureau book.

(Resolution adopted October 25, 1926, and revised February 6, 1933 and February 24, 1941)

Financial Research Program: Committee

In the conduct of this and other studies under its program of research in finance the National Bureau of Economic Research has benefited from the advice and guidance of its Committee on Research in Finance. The functions of this committee are to review and supervise the specific research plans of the staff of the Financial Research Program. The membership includes:

WINFIELD W. RIEFLER, Chairman—*Institute for Advanced Study*

RALPH A. YOUNG, Secretary—*University of Pennsylvania; Director, Financial Research Program*

WILLIAM J. CARSON—*University of Pennsylvania; Executive Director, National Bureau of Economic Research*

DAVID FRIDAY—*Consulting Economist; Director, National Bureau of Economic Research*

E. A. GOLDENWEISER—*Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System*

F. CYRIL JAMES—*Principal and Vice-Chancellor, McGill University*

WALTER L. MITCHELL, JR.—*Director of Surveys, Research and Statistical Division, Dun and Bradstreet, Inc.*

WESLEY C. MITCHELL—*Columbia University; Director of Research, National Bureau of Economic Research*

SHEPARD MORGAN—*Vice-President, Chase National Bank; Treasurer, National Bureau of Economic Research*

RAYMOND J. SAULNIER—*Barnard College, Columbia University; Research Staff, National Bureau of Economic Research*

WOODLIEF THOMAS—*Assistant Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System*

DONALD S. THOMPSON—*Chief, Division of Research and Statistics, Federal Deposit Insurance Corporation*

ROBERT B. WARREN—*Institute for Advanced Study*

JOHN H. WILLIAMS—*Littauer School, Harvard University; Vice-President, Federal Reserve Bank of New York*

LEO WOLMAN—*Columbia University; Research Staff, National Bureau of Economic Research*

DONALD WOODWARD—*Research Assistant to the President, Mutual Life Insurance Company of New York*

RAYMOND J. SAULNIER and NEIL H. JACOBY

ACCOUNTS RECEIVABLE FINANCING

Financial Research Program

Studies in Business Financing

NATIONAL BUREAU OF ECONOMIC RESEARCH

332
S85A
4225

658.15
S87A

COPYRIGHT, 1943, BY NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.
1819 BROADWAY, NEW YORK, N. Y. ALL RIGHTS RESERVED

PRINTED IN THE UNITED STATES OF AMERICA BY
THE HADDON CRAFTSMEN, INC., SCRANTON, PENNA.

Preface

STUDIES IN BUSINESS FINANCING, the second major investigation of the National Bureau's Financial Research Program, was begun early in 1940 under grants from the Association of Reserve City Bankers and the Rockefeller Foundation. This project has had three major objectives: first, to trace from business accounting records the structural and cyclical changes that have occurred in the financial organization of business enterprise since the turn of the present century; second, to determine for recent years the cross-sectional pattern of business credit demands; and third, to describe the adaptations that financing institutions providing short- and medium-term credit have made in response to changing demands for their services.

Research activities have been carried on under two main divisions: "Changes in Financing American Business Enterprise, 1900-40," concerned primarily with the first objective, and "Contemporary Relations Between Business Enterprise and Financial Institutions," devoted specifically to the second and third objectives. Because of the breadth of the field covered by these two divisions, it proved expedient to prepare a number of complementary technical studies under each, in order to develop and systematize materials in limited areas for later use in more general interpretative studies. While each of the technical studies is of restricted scope, together they build up a more complete analysis of changes and adaptations in business financing than would otherwise be possible. Studies prepared under the two divisions will be summarized in a final interpretative volume.

Accounts Receivable Financing is one of the four technical studies prepared under the second division by Neil H. Jacoby and Raymond J. Saulnier. *Term Lending to Business* was the first publication in this series on contemporary relations between business and lending agencies. Other studies cover equipment financing and field warehousing.

The preparation of each of these studies has required extensive interviews with officers of specialized financing agencies and commercial banks in the main lending centers east of the Mississippi; further statistical information has been assembled through special questionnaires. We wish to acknowledge our obligation to these officers for their generous help, as well as to the financial agencies that cooperated in supplying statistical information through questionnaires. Without this cordial assistance, these studies would be far less rich in factual detail and the treatment would be far less adequate.

Changing demands of business for short- and medium-term credit have produced two major types of adaptations on the supply side of the business financing market. Commercial banks have made marked changes in their lending policies and techniques while lending agencies have developed outside the private banking system to meet newer kinds of credit needs. The rapidity with which these adaptations have been accomplished is perhaps responsible for the fact that little is known of their character and extent. Accounts receivable financing, particularly in its non-notification aspect, constitutes one of the most interesting and important of these changes in business financing methods.

This study attempts to present the development of all receivables financing through the operations of factors, commercial finance companies and commercial banks; to develop estimates of its quantitative importance; and to show the types of clients served and types of services offered by each of the principal receivables financing agencies.

RALPH A. YOUNG
Director, Financial Research Program

January, 1943

Authors' Acknowledgments

MANY PEOPLE HAVE CONTRIBUTED generously of their time and experience to the planning and conduct of the present study. Among these, Ralph A. Young, Director of the Financial Research Program, and Winfield W. Riefler, Chairman of the National Bureau's Advisory Committee, have been most intimately connected with the initiation and progress of the investigation. The authors are especially grateful to them for the technical advice and personal encouragement given at all stages of the work. Stanley L. Miller, formerly of the staff of the Financial Research Program, participated in much of the research activity undertaken in connection with receivables financing and we acknowledge gratefully the important contributions he made to the analysis.

So many others have assisted in the conduct of the investigation that it is impossible to make specific acknowledgments. The officers of nearly 300 commercial banks made possible, through their completion of questionnaires, the estimates of commercial bank receivables loan volume. A number of bank officers have made indispensable contributions to the work through extensive interviews and by preparing the special schedules of information that provide the main statistical basis of our discussion of bank non-notification financing. Officers of a number of commercial fianance companies and factoring companies have talked with the authors at considerable length, thus giving us the benefit of their wide experience in a field little known by those outside it and, further, have permitted us to study at first hand the technical operations of their companies. The study has profited greatly from the wholehearted support of these men and the concerns they represent; the

authors are especially pleased to make grateful acknowledgment of their very kind assistance.

The authors wish, also, to express their gratitude to the staffs of Dun & Bradstreet, Inc., and the National Credit Office, Inc., for their cooperation. Members of the examining divisions of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York and the Federal Deposit Insurance Corporation have discussed with us certain aspects of receivables loans as made by commercial banks and we are deeply appreciative of their help.

Lorine Pruette undertook editorial responsibility on the manuscript and has made contributions to the sharpness and readability of the discussion for which we are most grateful. Renée S. Courtney was responsible for the checking of statistical details and for much of the task of seeing the manuscript through the press.

RAYMOND J. SAULNIER
Financial Research Program
and
Barnard College, Columbia University

NEIL H. JACOBY
Financial Research Program
and
University of Chicago

Table of Contents

PREFACE vii

AUTHORS' ACKNOWLEDGMENTS ix

LIST OF TABLES xiv

SUMMARY OF FINDINGS 1

1. THE DEVELOPMENT OF ACCOUNTS RECEIVABLE FINANCING (15-31)
   - Definition of Accounts Receivable Financing 17
   - Business Demand for Factoring Services 18
   - Business Demand for Non-Notification Financing 20
   - Commercial Bank Activity in Receivables Financing 25

2. THE VOLUME OF ACCOUNTS RECEIVABLE FINANCING (32-38)
   - Factors 33
   - Commercial Finance Companies 34
   - Commercial Banks 36

3. INSTITUTIONAL FACILITIES (39-57)
   - Factors 39
   - Commercial Finance Companies 47
   - Commercial Banks 53

4. CHARACTERISTICS OF CLIENTS (58-69)
Clients of Factors 58
Clients of Non-Notification Financing Agencies 61

5. CREDITS AND ASSOCIATED SERVICES (70-91)
Size of Credits Extended 70
Factoring 70
Non-Notification Financing 72
Average Size of Client's Receivables 77
Factoring 77
Non-Notification Financing 78
Term and Repayment Provisions of Credits 79
Factoring 79
Non-Notification Financing 81
Percentage Advance on Accounts Receivable 85
Factoring 85
Non-Notification Financing 86
Services Associated with Receivables Financing 88
Factoring 88
Non-Notification Financing 89

6. POLICIES AND PROCEDURES (92-127)
Organization and Personnel 92
Methods of Acquiring Business 97
Formulation of the Financing Contract 100
The Factoring Contract 100
Commercial Finance Company Non-Notification Contract 104
Commercial Bank Non-Notification Agreement 106
Credit Analysis and Standards of Commercial Finance Companies 109
Appraising the Client 110
Appraising the Collateral Security 115
Controlling an Active Loan 117
Credit Analysis and Standards of Commercial Banks 120
Other Risk-Limiting Procedures 124

7. CLIENT CHARGES, OPERATING EXPENSES AND PROFITS (128-143)
Client Charges 128
Factors 128
Commercial Finance Companies 131
Commercial Banks 134
Costs of Operation 138
Gross Income, Gross Expense and Net Profits 142

APPENDICES

A. PROCEDURES FOLLOWED IN ESTIMATING FACTORING VOLUME (147-148)

B. PROCEDURES FOLLOWED IN SELECTING COMMERCIAL BANK SAMPLE (149-150)

C. SUPPLEMENTARY TABLES (151-152)

List of Tables

1. Estimates of the Volume of Accounts Receivable Financed by Factoring Companies, 1928-41 — 34

2. Estimate of Total Outstanding Accounts Receivable Loan Balances of Commercial Banks as of December 31, 1940, by Deposit Size of Bank — 37

3. Principal Asset and Liability Items of Factoring Companies, 1925-41, in Percent of Total Assets — 43

4. Principal Asset and Liability Items of Five Factoring Companies, December 31, 1941, in Percent of Total Assets — 46

5. Principal Asset and Liability Items of Six Commercial Finance Companies, December 31, 1941, in Percent of Total Assets — 51

6. Amount of Accounts Receivable Loans and Total Loans of Commercial Banks, and Accounts Receivable Loans in Percent of Total Loans, as of Mid-1940, by Deposit Size of Reporting Bank — 56

7. Total Assets and Gross Sales of Textile Manufacturers, 1937, by Asset Size — 59

8. Number and Amount of Accounts Receivable Loan Balances, by Main Business Activity of Client — 62

9. Number and Amount of Accounts Receivable Loan Balances, by Average Loan Balance and by Client's Total Assets — 63

10. Average Amount of Receivables Held by One Regional Commercial Finance Company Per Client and Per Trade Debtor, December 31, 1940, by Industry of Client — 65

11. Accounts Receivable Loan Balances, Classified by Ratio of Borrower's Net Worth to Total Assets — 68

12. Accounts Receivable Clients, 1940-41, by Average Loan Balance and by Main Business Activity — 73

13. Average Accounts Receivable Loan Balances of Retail and Other Clients, June 1941, by Deposit Size of Bank, Size of Population Center and Region in Which Bank is Located — 76

14. Accounts Receivable Loan Balances, 1940-41, by Percentage Advanced and by Size of Annual Average Loan Balance — 87

15. Reserves for Losses, Amounts Due to Manufacturers and Others, and Reserves for Discount of Two Factoring Companies, in Percent of Receivables Held on December 31, 1937-41 — 126

16. Gross Income and Percentage Distribution by Source of Income for Two Commercial Finance Companies and One Factoring Company, 1933-40 129

17. Operating Income of One Commercial Finance Company, 1934, by Type of Business 132

18. Percentage Distribution of Total Expenses of One Factoring Company, 1933-41, by Type of Expense 138

19. Expense Items of One Commercial Finance Company, September 2, 1937 to December 31, 1938, in Percent of Total Expense and in Percent of Gross Income 140

20. Percentage Distribution of Total Expenses of Three Commercial Finance Companies, 1932-40, by Type of Expense 141

C-1 Number of Banks Reporting on Participation in Accounts Receivable Financing, by Deposit Size of Bank, Size of Population Center and Region in Which Bank is Located 151

C-2 Accounts Receivable Loan Balances in Amount, and in Percent of Total Loans and Discounts, by Size of Population Center and Region in Which Bank is Located 152

FINANCIAL RESEARCH PROGRAM OF THE
NATIONAL BUREAU OF ECONOMIC RESEARCH

Accounts Receivable Financing

Summary of Findings

THE SHORT-TERM CREDIT NEEDS of an increasing number of businesses are now being satisfied through the sale or assignment of accounts receivable. This widening use of receivables financing is the more notable in that it has occurred without any organized encouragement from public or private agencies, while trade acceptance financing, which did have assistance and encouragement, has failed to assume important proportions. The procedure of accounts receivable financing is not a new one, but it has only recently begun to attract attention. The growing participation of commercial banks is one of the chief reasons for the increased interest in this method of financing. In addition, receivables financing represents a technique which, while frequently used by companies in a strong credit position, is particularly valuable in extending credits to concerns that might otherwise find it difficult or impossible to obtain adequate financing. Recent discussions of the availability of credit to small business have, therefore, called special attention to receivables financing.

Accounts receivable financing may be defined as a continuing arrangement through which a financing agency makes funds available to a business concern by purchasing its invoices or accounts receivable over a period of time, or by making advances or loans, taking one or a series of assignments of accounts as primary collateral security. These arrangements are of two general types. The first—known as "factoring"—is conducted by factoring companies and involves the purchase by the factor of a concern's accounts receivable, generally without recourse on the vendor for any credit loss on accounts and with notice given to trade customers that their accounts

have been purchased. The second—known as "non-notification financing"—is conducted mainly by commercial finance companies and commercial banks and involves the purchase of receivables or their assignment as collateral security for a loan, without notice to the trade customer and without the assumption by the financing agency of the risk of credit loss on receivables sold or assigned.

The present study deals with both of these arrangements, although two principal limitations must be noted. First, it deals with the financing of *open* as contrasted with *instalment* receivables and, second, it is concerned with receivables financing undertaken on its own merits as contrasted with assignments of receivables taken as additional security for an advance of funds in which primary reliance is placed on some other type of security device, or as an emergency measure adopted to "work out" a loan made previously on some other basis.

Factoring was the earliest form of accounts receivable financing, developing as early as the fourteenth century, when the factor was prominent in financing foreign trade. With the growth of commerce and industry the factor assumed greater importance and widened functions, purchasing accounts receivable mainly from textile manufacturing concerns (thus enabling clients to extend trade credit and at the same time to receive cash at time of sale), performing a credit selection and collection service, assuming credit risks on trade receivables, acting as selling agent and providing advice on styling and merchandising. In recent years, however, the merchandising functions have been dropped by most factoring companies.

In view of the fact that non-notification financing has not provided, on any systematic basis, for the merchandising and other management counseling functions formerly characteristic of factoring its growth must be explained mainly in terms of a need for funds. However, commercial finance companies now offer certain supplementary services, such as general management advice.

Demand for non-notification financing comes from two types of concerns, those unable to obtain sufficient funds on any other basis, and those that find the terms of receivables-borrowing most nearly suited to their needs. It is inaccurate to say that the demand for non-notification financing comes exclusively from concerns of relatively low credit standing, although the erosion of working capital caused by operating losses during the early thirties led an increasing number of such concerns to seek this method of obtaining funds.

Commercial banks have turned to non-notification financing under pressure of a situation in which their lending capacity has been only partially used and returns on bank assets have declined sharply. The successful operation of finance companies and factors has also stimulated interest in such financing on the part of commercial banks. On the other hand, the legal conditions under which accounts receivable financing must be conducted by commercial banks have served, in a number of states, to retard their activities. From the point of view of the banks, the primary legal problem is that of obtaining a valid assignment of the receivables without giving notice to trade customers. In some states this is impossible; in others it involves procedures that make the operation unattractive. There are many states, however, in which the legal conditions are favorable and, in these states particularly, commercial banks are showing a rapidly growing interest in receivables financing. Furthermore, there is a tendency for more states to pass legislation to simplify the financing procedure.

The relative quantitative importance of the principal receivables financing agencies is indicated by the following estimates. The volume of sales factored by factoring companies was close to $800 million in 1940, and $1,150 million in 1941; commercial finance companies, including both large local and regional companies as well as the more numerous small local companies, financed approximately $411 million in receivables in 1940, $536 million in 1941; commercial banks financed open accounts receivable of approximately

$826 million in 1940, $952 million in 1941. This places the total 1940 volume of accounts receivable financed at approximately $2 billion and the 1941 volume at about $2.6 billion.

Factoring is conducted almost exclusively in New York City, by companies many of which were founded in the first decade of the nineteenth century, or are derivatives of companies founded during that period. The business is concentrated in a small number of relatively large companies as the result of a widespread consolidation movement around 1930. The assets of these companies, several of which conduct an annual volume of about $125 million, are primarily accounts receivable acquired in factoring operations. A relatively small proportion of their assets is in advances made on merchandise held by their clients, an item that has tended to decrease since the early twenties. The asset structure of commercial finance companies is more diversified than that of factors, their receivables being acquired in various kinds of financing —notification and non-notification receivables financing, consumer instalment financing, commercial and industrial equipment financing, rediscounting for other finance companies and, to a limited extent, cash lending to consumers and business enterprises. Diversification is particularly characteristic of the larger finance companies.

Both factors and commercial finance companies obtain their funds mainly from invested capital and short-term bank borrowings. Net worth tends, in both types of companies, to be about 20 to 35 percent of total assets, and year-end notes payable amount to between 40 and 50 percent of total assets. Other liabilities are mainly reserve accounts. In general, the ratio of debt to equity tends to be higher for the larger than for the smaller companies.

The results of a questionnaire survey conducted in the summer of 1941 showed that about one out of every four commercial banks was active in accounts receivable financing. Participation in this type of financing is more characteristic of the larger banks, of those located in the larger centers of population and of those banks located in regions primarily

industrial and commercial in nature. But while accounts receivable financing is conducted by many commercial banks, it is of minor quantitative importance, amounting to only 1 percent of the total loans and discounts of the reporting banks. In general, these loans represent a smaller proportion of the loans of the larger banks than of the smaller institutions.

Very little factual information is available on the number and type of clients served by factoring companies. They are described as manufacturers, converters and selling agents; the receivables purchased from them are mostly obligations of manufacturers, wholesalers and retail outlets. While no statistical information is available on the kinds of commodities produced by manufacturers using a factor's services, it is known that, in general, this type of financing has been confined almost exclusively to the cotton, silk, rayon, and woolen and worsted trades of the textile industry. Recently, however, there has been a tendency for factors to serve manufacturers outside the textile field and this movement is steadily developing. The number of clients served by individual factors varies all the way from 100 to 500. The amount of receivables sold to the factor annually may range from $200 thousand to $2 million for individual clients, with some clients orginating even larger amounts.

Special schedules of information supplied by 24 commercial banks and 2 commercial finance companies reveal something of the market served by non-notification agencies. Of the loan balances reported, 70 percent were for manufacturing concerns, 14 percent for wholesalers and 11 percent for retailers. In the manufacturing group there was a very wide distribution of clients among the various types of manufacturers, indicating that currently non-notification financing is much more widely diversified throughout industry than is factoring.

Most of the clients of factoring companies are concerns with total assets of between $100 thousand and $3 million. The more complete information on non-notification financing agencies shows that smaller concerns constitute a large fraction

of all clients but are much less important, as regards volume of business originated, than the larger though less numerous clients. Thus, of 354 non-notification clients reported, 57 had total assets of less than $25,000 but originated less than 2 percent of all balances reported; concerns with total assets of less than $200,000 accounted for 63 percent of all clients but only 15 percent of all loan balances reported.

There is no direct statistical evidence concerning the financial position of the concerns obtaining funds on a non-notification financing basis. It is known, however, that the ratio of equity to total assets for these companies is somewhat lower than the ratio for all concerns in the United States of roughly the same size. Also, it is known that concerns borrowing on a non-notification basis do not generally continue to finance themselves in this manner for long periods; apparently many of them either strengthen themselves to the point where they are able to shift to some other borrowing arrangement, or else they go out of business. Finally, while non-notification clients may obtain additional funds on another borrowing basis, it is more frequently the case that these concerns depend exclusively on accounts receivable financing. Of 358 reported clients, 173 received funds on no other basis than through the sale or assignment of their receivables.

Commercial finance companies and commercial banks usually set a maximum limit to the accounts receivable that they are willing to hold for individual clients at any one time, because in non-notification financing the potential recourse against the client is related to the amount of his capital, the percentage advanced on receivables and the diversification and quality of the client's receivables. This limit, however, is a flexible one and is set for general control purposes. In factoring, since the factor generally has no recourse on the client for credit losses on unmatured sales, any limits that are set are of a different kind. In both of these fields the extent of the financing agency's investment in the business of the client can be measured by the amount of the client's unmatured sales held by the financing agency. In general, the amounts held

in non-notification financing are smaller than in factoring.

Both commercial finance companies and commercial banks reported that they held less than $10,000 of receivables for each of approximately half their borrowers. It should be added that balances of this size accounted for only 5 percent of the amount of all balances reported. The average size of such balances was largest in the larger banks, in those located in the larger centers of population and in those banks in the predominantly commercial and industrial regions of the country.

In factoring, the amount of unmatured sales held for the bulk of the clients ranges from $30,000 to $300,000 per client. Here also, most of the factor's total volume of business is done with those clients for whom the factor holds the largest balances of unmatured sales. It should be pointed out that, in addition to purchasing receivables, the factor may make advances on merchandise to certain clients although this is becoming a less frequent practice. In this case limits are set on the amount that will be loaned a given client; the upper limit may be the amount of one month's sales, an agreed percentage of the client's net quick assets or net worth, or an agreed percentage of orders in process of completion, depending on the financing agency's judgment.

Individual invoices or accounts purchased or taken on assignment are generally very small in amount. Of all balances reported by non-notification agencies 47 percent were secured by invoices averaging less than $250; over 25 percent of the clients produced invoices of less than $100 in average amount. In some cases, of course, the average invoice was very large; 26 percent of the balances represented clients' invoices of $5,000 and over. The average size of the clients' invoices or accounts is important in the sense that in most operating procedures each represents a separate bookkeeping and accounting problem for the financing agency. Thus, the average size of the individual transaction has a considerable effect on operating costs per dollar of outstandings.

There is only one sense in which it can be said that the fac-

toring arrangement has a term or contractual period; that is that the contract between factor and client stipulates a period during which the factor agrees to purchase and the client to sell his receivables. This period may be one year or longer; in some cases no period is set but the arrangement may be brought to a conclusion by ninety days' notice at any time. The contractual relationship between non-notification agencies and their clients generally stipulates no period but is terminable on thirty days' notice; there seems to be a current tendency, however, for non-notification contracts to be written on a term basis, for example, for a one-year period. The average maturity of the receivables purchased, which varies with the trade terms offered by the client, is of decided importance. In non-notification financing the period is generally about 50 days; in factoring it varies from 35 to 50 days. The average period of the client's receivables also affects the cost of financing but this is compensated for by the fact that charges are frequently based at least in part on volume of receivables handled.

In accounts receivable financing the collections on receivables supply the means whereby the financing agency's investment in the client's business is reduced. In factoring, since the accounts have been purchased outright, collections on all accounts are merged to reduce the factor's whole investment in receivables. Commercial finance companies apply the collections directly to the amount of their client's balance, each account being handled separately. When commercial banks take assignments of receivables as security for loans, the loan balance is paid down immediately as collections are made or at intervals, through withdrawals from a cash collateral account into which collections are paid as received. In non-notification financing the client usually contracts to take up receivables that are unpaid on their due date but an additional period—30 or 60 days after maturity, and possibly longer—is provided for in practice.

In both factoring and non-notification financing, funds are advanced only up to a certain percentage of the face amount of receivables acquired: from 70 to 90 percent in non-notifica-

tion financing and 90 to 95 percent in factoring. In factoring this margin protects mainly against returns of merchandise; in non-notification financing the percentage advance is determined by reference to past experience with returns, discounts and allowances, the cost of goods sold (on the ground that profits should not be advanced) and by the general credit risk presented by particular clients.

Two characteristics of accounts receivable financing exert important effects on the way this business is conducted. First, the average invoice purchased or taken on assignment and the average collections are so small that operations must be organized along relatively routine lines. This makes possible the most economical conduct of what is necessarily a mass or aggregate financing operation. Second, since receivables financing presupposes a *continuing* relationship with a frequent turnover of receivables it is usually the case that a formal contract is drawn up stating the rights and obligations of both parties.

Although operations are routinized in the interests of economy, the need for careful and thorough credit appraisal is of peculiarly great importance in receivables financing. The factoring company is particularly vigilant especially as regards the trade debtor, because it assumes the credit risk on the receivables purchased; the non-notification agency must be careful because its borrowers include many who are acquiring more funds on their receivables than they could get under any other financing arrangement. In order to limit the risks undertaken the different agencies have worked out very careful procedures and established definite standards in the light of their special credit problems.

A careful appraisal is made of each prospective client, involving a thorough audit of the applicant's business and, in particular, of the receivables, which are classified according to maturity, amount, collection and credit loss experience, credit rating and other important characteristics. Returns of merchandise are studied, as well as shrinkage in the face amount of receivables resulting from the discounts deductible

by customers. This appraisal enables the finance company or bank to set a limit to the amount of the client's receivables that it is willing to hold, to determine the amount of the payables of any individual trade customer that it is willing to accept, and to determine which, if any, of the client's receivables are unacceptable. As part of the original investigation of a client, the finance company or bank also verifies individual accounts to trade customers, taking a sample or investigating all the accounts outstanding. The factor's initial appraisal and investigation is similar to that of other agencies; when the factoring process actually begins there are certain important differences. For example, all sales must be submitted for the factor's credit approval before being made.

The initial appraisal does not complete the credit work of the financing agency; on the contrary, credit appraisal is a continuing process. Each invoice or receivable originated and offered by the client must be classified for approval or rejection unless there is a large number of very small invoices, in which case the average experience serves as a guide. This calls for a regular testing of accounts sold or assigned; certain standards may be applied in special cases, for example, no more than one invoice may be held for a particular trade customer or a maximum may be set on the amount of a given trade customer's invoices that will be accepted by the finance company or approved by the factor. In addition, supervision is maintained over all receivables held and collections received. The financing agency must keep a record of credit losses, returns of merchandise and deductions for discounts; frequent analyses are made of the composition of receivables purchased, lest the general credit standing of the customers of the agency's clients should weaken. In non-notification financing regular verifications are made of receivables acquired and surprise field audits are made at fairly frequent intervals to determine whether the client is making proper assignments of accounts on his books and whether remittances are being promptly redirected to the financing agency.

The objective of most of this credit appraisal work is to

set the percentage advance at a point that will provide the commercial finance company or bank with an appropriate margin of safety and to guide its policy with respect to loss reserves. In factoring it serves to determine the balance that individual clients may be expected to keep with the factor and also to govern the loss reserves that the factor keeps to absorb shrinkages in the face value of receivables purchased and general losses sustained in its business. These reserves are usually between 1 and 2 percent of the amount of receivables held. Since the commercial finance company usually consolidates different types of financing on its balance sheet it is not possible to state its reserve policy with respect to open accounts receivable financing. As additional measures, the non-notification client may, optionally or by requirement, take out credit insurance on receivables sold; it may be requested to supply fidelity bonds to protect the financing agency from fraud or asked to assume a partial or complete personal liability for the account.

Any analysis of charges levied in connection with receivables financing, and in particular a comparison of these charges with rates for financing services of other kinds, must take careful account of two conditions. First, the client may receive a number of non-credit services in addition to the advance of funds. Second, the risks presented by non-notification clients are relatively higher than those presented by borrowers on more conventional bases and the task of reducing these risks to manageable limits involves the use of specially designed procedures. Both of these conditions tend to make this type of financing more costly to conduct and, to that extent, lead to higher charges to the client.

Factoring companies quote their charges in two parts, as a commission on the amount of receivables purchased and as a per annum rate at which receivables are discounted prior to maturity. Commissions account for between 60 and 70 percent of the gross income of factors; they vary between .75 and 2 percent of sales cashed and have shown some tendency to decline in recent years; the interest charges levied by fac-

tors make up approximately 30 to 40 percent of their gross income and generally amount to 6 percent per annum. The charge levied by the commercial finance company in non-notification financing is generally quoted as a certain percent per day of the total gross amount of the customer's receivables held by the financing agency. Rates have been tending to decline and at present they vary between 1/50 of 1 percent and 1/25 of 1 percent per day, with a large proportion of the contracts calling for a rate of 1/40 of 1 percent per day. These rates are applied to daily balances of receivables or collateral held and, where the commercial finance company advances only a certain percentage of the total amount of receivables held, an adjustment has to be made in calculating the annual effective rate to the borrower. Assuming a 75 percent advance, a daily rate of 1/50 of 1 percent on collateral held amounts to an annual effective rate of 9.7 percent, a 1/40 rate to 12.2 percent and a 1/25 to 19.5 percent. Assuming a 90 percent advance, a daily rate of 1/50 of 1 percent equals an annual effective rate of 8.1 percent, a 1/40 rate equals 10.1 percent and a 1/25 rate equals 16.2 percent.

Rates charged by commercial banks on collateral loans secured by assigned accounts receivable are quoted in a number of ways. First, interest rates may be charged on outstanding loan balances, without any additional fee or charge of any kind. By and large, this seems to happen most frequently where banks make very few receivables loans. In general these rates are from 5 to 6 percent per annum, most frequently the latter; occasionally the rate has been as low as 4 percent. The effective rate to the customer on such an arrangement depends, of course, on the procedure followed by the bank in applying collections to the loan account. Where the bank uses a cash collateral fund and does not apply collections promptly, a borrower pays an effective rate higher than the quoted rate; however, since the term of the borrower's note is usually geared to the maturity of the receivables assigned, it seems

reasonable to conclude that the effective rate on money in use would generally be no more than one-third in excess of the quoted rates. Other commercial banks charge a given rate on customer balances *plus* a service charge which may be quoted in a great variety of ways. When both these charges are taken into consideration, it appears that the effective rate to customers is seldom above 9 percent per annum and generally less.

Total expenses of factoring companies amount to approximately 70 to 80 percent of their gross income. Of these expenses, salaries, write-offs and other provisions for losses and interest on borrowed funds are the most important items. It is notable that interest expense on funds borrowed by factors declined in relative importance from 1933 to 1940, reflecting the more economical basis upon which funds were acquired from commercial banks and the slower withdrawal of funds from factors by their clients, which serves to reduce the factors' demand for funds from their lending banks. In 1941 increased borrowings brought about an increase in the relative importance of interest expense. The ratios of net credit losses on receivables to total receivables purchased are very low in factoring; these losses varied, for the one company on which information is available, between .1 and .5 percent over the seven-year period, 1934-40. Nevertheless, while low as a percentage of receivables purchased, losses represent a substantial part of total operating expenses.

The expenses of commercial finance companies amount to about 60 percent of their gross income; the most important expense items are salaries, provision for losses, and interest on borrowings. It is true of commercial finance companies also that interest and discount on borrowed funds have declined in relative importance as an expense item in recent years, falling from 29 percent in 1932 to about 14 percent in 1940.

Studies of the relation between gross income and gross operating expenses of factors, commercial finance companies

and commercial banks reveal quite clearly that the relatively high ratio of income to total assets for the non-banking agencies is largely offset by high operating expense ratios. Net operating profits related to net worth appear to be both higher and more variable for the non-banking than for the banking agencies.

1

The Development of Accounts Receivable Financing

When the federal reserve system was organized it was thought by many that two-name commercial paper would provide the chief medium through which the resources of the Reserve Banks would be made available to the banking community. As a result, considerable interest was focused on the trade acceptance; Federal Reserve authorities and other agencies encouraged its wider use in commercial transactions. It is well known that these efforts were for the most part unavailing; for a variety of reasons the trade acceptance did not come into as wide a usage as had been hoped for. Broadly speaking, the method of financing that was involved did not conform to the practices of American business.

While this attempt to promote the use of the trade acceptance was meeting with disappointing results, a related technique of business financing based on the open account sale of merchandise was developing in the American short-term credit market. This occurred not only without organized support or official sponsorship but even in spite of considerable resistance. The technique of open accounts receivable financing is important from a number of points of view, not the least of which is that it was apparently so well adapted to the financing needs of certain types of business concerns that it gained wide application while the trade acceptance of conventional form failed to develop even with the most patient cultivation.

Accounts receivable financing is not a new development. The open account has long been recognized as one of the preferred assets of business concerns; a good deal of the attention of the banker has always been centered on the amount and quality of these accounts and on their relation

to other quantities in the corporate balance sheet. Beyond this, the account receivable has been, for centuries, the specific basis of short-term financing in the textile trades by individuals and concerns known as "factors."

Of late there has developed a wider and keener interest in accounts receivable financing and in its position in the short-term credit market. This new interest can be explained by several related points. First, there is a present tendency for the technique to be applied to an ever-widening range of industries. This has given rise to new problems of credit appraisal and, to some extent, to new competitive situations in short-term financing. Second, non-bank institutions, other than the factoring companies that have long been active in receivables financing, have developed during relatively recent years and have come to occupy a prominent position in the short-term business credit field. Third, the business has recently been taken up by commercial banks, a development that can be traced primarily to the pressure that banks have felt for new avenues of credit extension and to the example of rapidly growing commercial finance companies. Fourth, although the movement has been retarded somewhat by the war program, an increasing number of business concerns are now depending on the sale or assignment of their receivables for the acquisition of working capital. Some of these do so because their financial position precludes borrowing on any other basis, others because they prefer receivables financing over other types of financing. Because many of the concerns financed through the sale or assignment of their receivables are relatively small and of limited financial strength the technique has received added attention in recent years in connection with questions relating to the availability of credit for small business enterprises.

While this study deals almost exclusively with accounts receivable financing, an attempt has been made to show how it is related to other financing methods. The study deals with the development and present quantitative importance of open accounts receivable financing; the nature of institutions extend-

ing credit on this basis; the main features of the services offered by them; the chief characteristics of the businesses obtaining financial support from these agencies; the methods followed in conducting such financing; and the charges levied, income earned, costs of operation, and profitability of the business.

Definition of Accounts Receivable Financing

Accounts receivable financing is a continuing arrangement whereby funds are made available to a business concern by a financing agency that purchases the concern's invoices or accounts receivable over a period of time or makes that concern advances or loans, taking one or a series of assignments of the accounts as primary collateral security.[1] There are two principal types of receivables financing. One type is known as factoring. This consists of purchasing invoices or receivables, where trade debtors are notified that payments are to be made to the financing agency and where this agency generally assumes the credit risks on the receivables. The other major type will be referred to as non-notification financing. This involves the purchase or assignment of invoices or receivables without notice to the trade debtor that the account has been sold or assigned and without the assumption by the financing agency of credit risks on purchased or assigned accounts.

Two limitations on the scope of the study should be noted. First, primary emphasis is laid on the financing of open accounts receivable as distinguished from the financing of instalment notes receivable. The discounting of instalment receivables has been discussed in detail in previous studies of the National Bureau of Economic Research.[2] Second, this

[1] In factoring and in non-notification financing as conducted by commercial finance companies the financing agency buys invoices rather than accounts receivable, which may be cumulations of several unpaid invoices. Although "invoice financing" is a more strictly accurate term for this type of arrangement the expression "accounts receivable financing" is widely used in the trade and will be used here.

[2] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices,* by Wilbur C. Plummer and Ralph A. Young (1940); and *Commercial Banks and Consumer Instalment Credit,* by John M. Chapman and Associates (1940).

study does not treat, except incidentally, of the use of the accounts receivable financing technique by commercial banks as a method of "working out" unsatisfactory credit relationships arising from previous loans made on another basis. It is concerned with open accounts receivable financing entered into on its own merits, where the primary dependence of the financing agency is, from the outset, on the purchased or assigned account receivable.

Business Demand for Factoring Services

Accounts receivable financing, as a technique for supplying funds to business enterprises, evolved many years ago out of business demands that went far beyond the need for advances of funds. As early as the fourteenth century, manufacturers and merchants in both foreign and domestic trade felt the need for some specialized agency to perform a selling and merchandising service for them (not unlike that offered by the commission merchant in more recent times). Since sales were generally made on credit terms of 30 days or longer, it proved to be convenient for the agency responsible for making sales also to advise on the wisdom of extending trade credit to any given buyer. Finally, this agent (the "factor") undertook in some instances to absorb losses arising out of credit sales by buying the open accounts so originated without recourse on the seller (the factor's "client"). In effect, the seller or manufacturer was placed in the position of making all sales for cash.

The demand for this combination of services prompted the emergence of factoring as an economic function. The nature of the services performed by the factor clearly indicates that such services would be particularly useful to concerns selling in foreign markets in which the creditworthiness of buyers was unlikely to be known to the sellers. For this reason the factor came to occupy an important place in American colonial trade, operating as buyer, sales agent, carrier of credit risks, collector of accounts, and general commercial representative on this continent for English companies. The selling and styl-

ing functions of the factor proved to be particularly important in the textile trade where market demand was much affected by fashion changes. Thus, in the nineteenth century the factor was prominently associated with sales in the United States by foreign textile mills and later assumed a major role in financing domestic mills and in marketing their product. Because of the importance of the import market in textiles, and particularly because of their role as selling agents, factors early established themselves in Boston and New York. With the greater growth of New York in importing and merchandising, factoring companies gradually centered in that city. The tendency for these companies to locate on Fourth Avenue, in close proximity to one another, has led to their being referred to as "Fourth Avenue houses." More recently they have been designated as the "old-line" or "straight" factors, in distinction from the newer open accounts financing companies.

In recent years there has been a tendency for the selling and merchandising functions of the factor to be detached from the financing function. It is customary now for the factor's clients either to organize their own sales departments or to use the services of a specialized selling agency or "commission house." In some cases the commission house also performs a financial function, but this service is available only to the manufacturers whose goods it sells.[3]

A number of reasons explain this tendency for the factor's activities to be limited to the performance of a financing function. One is the advantage of specialization gained by the factor, another the independence achieved by the mill that sets up its own sales department. Still another is the fact that while the factor was under no formal obligation to do so, he often had to make loans on goods which he had styled and which proved to be less readily salable than had been antici-

[3] It should be emphasized that this change in the functional and institutional pattern of the market has not resulted in an absolutely clear-cut difference between the factor and the commission or selling house. There are some firms, for example, J. P. Stevens and Co., Inc., New York City, that undertake both functions. The concentration of commission merchants on Worth Street, New York City, accounts for their being designated "Worth Street houses."

pated; frequently these loans were the source of substantial losses. All of these causes were amplified by the growing complexity of the market, its greater susceptibility to fashion influences and the desire of both factor and manufacturer to obtain as stable an economic position as possible.

Through this specialization, the main functions of the factor have come to be the purchasing of receivables with assumption of the credit risk [4] and the necessary corollary of collecting accounts. The performance of this risk-taking function made it necessary for the factor to develop an expert credit appraisal technique and an effective collection procedure and to assemble a specialized personnel to carry on this work. Further, the assumption of credit risks made it necessary to notify the trade debtor of the factor's purchase of the receivable and to instruct that payments be made directly to the factor. In contrast, the mill utilizing the factoring service did not need to maintain an extensive credit department, often none at all, nor to concern itself with the collection of accounts. Furthermore, it was relieved of a large part of its bookkeeping.

It is important to recognize that receivables financing, as offered by the factor, is provided jointly with these other services. The growth and continuance of the demand for factoring must be understood in terms of a demand for this combination of services. Also, the level of client costs, which is higher than that characteristic of some other types of financing, must be interpreted in the light of the variety of functions performed by the factor.

Business Demand for Non-Notification Financing

The conditions that led to the development of non-notification receivables financing differ in a number of important respects from those that account for the growth of factoring. In contrast to the conditions affecting factoring, the demand for non-notification financing is not necessarily associated with a demand for credit approval, collection or risk-assumption

[4] This function is sometimes referred to incorrectly as "insuring" credits.

services. The business enterprise seeking capital on this basis usually desires to convert its open accounts into cash without disclosing the fact that it obtains funds in this way. Since its customers are not notified that their accounts have been sold or assigned it is therefore necessary that the concern being financed make collections on its own receivables and turn these collections over to the financing agency. The fact that collections are made in this way raises considerably the risks undertaken by the financing agency and explains in large part why the receivables are purchased with recourse on the borrower. Under this arrangement the concern selling or assigning its receivables (the "client") must agree either to repurchase those of its receivables that become excessively delinquent or to substitute acceptable receivables for them. Consequently, the client must operate his own credit department in order to assure himself that his sales do not produce an unreasonable proportion of credit losses. The financing agency is concerned mainly with determining the validity of the accounts taken, avoiding loss through fraud and assuring itself as to the continued solvency of its clients; to this end it also operates a specialized credit department.

A number of forceful reasons account for the use of the non-notification procedure.[5] It developed much later than old-line factoring, not being practiced on any considerable scale until after 1908. Although notification had been well established in the textile trade for many years before that time, when concerns in other industries sought funds on the basis of their open accounts they had no precedent to support this policy. Their customers were unaccustomed to making payments to third parties; the only occasion for this would arise out of the placing of accounts in the hands of a collection agency and this action was generally regarded as a sign of financial embarrassment either on the part of the concern or of its customer.

[5] On this point see *The Receivables Business,* a reprint of an extemporaneous address given in Boston by A. E. Duncan, Chairman of the Board, Commercial Credit Company, before the Robert Morris Associates, November 16, 1923.

Another reason for the use of the non-notification procedure, although less important than other motives and less relevant at present than formerly, seems to have been the desire on the part of the concern being financed to keep the fact of its use of this source of funds from becoming known to its creditors. Presumably these creditors would be less likely to grant the concern further credit on the ground that resort to accounts receivable financing reflected an unsatisfactory financial position and impaired their own security. It seems likely that this attitude toward non-notification financing may be traced to a mixture of simple prejudice and genuine experience with cases where creditors' meetings disclosed for the first time that the bankrupt had secretly assigned his most liquid assets and made unproductive use of the funds so acquired. Genuine experience must have been the more important basis of the two for it is unlikely that an attitude and prejudice so deeply imbedded could be founded entirely on misinformation and irrational judgment. On the other hand, the fact that commercial banks, the agencies most frequently antagonistic to the procedure, are at present becoming more active in this type of financing would seem to indicate that "tragic experience" was not the sole ground of opposition and that lack of understanding, more attractive alternative uses for funds, or a combination of these reasons had a large part in it.

While the above conditions account for the use of the non-notification feature in receivables financing, other considerations, any one or more of which may be relevant to a particular borrower, account for the use of the receivables financing technique itself. First, some concerns able to obtain funds through this arrangement would not have credit facilities available to them on any other basis. A concern ineligible for open-line credit may be made creditworthy by the sale or assignment of its receivables. In taking receivables the financing agency may shift its emphasis from the financial condition of its client to the quality of its client's customers and thus

qualify certain concerns that would not otherwise be able to obtain funds.

Second, this type of financing may be used by concerns that, while they can get some credit on other bases, can borrow more heavily by pledging their receivables. This is especially likely where a concern has a seasonal business requiring short-term financing in amounts considerably beyond what would be appropriate on an unsecured open-line basis or where the concern's sales are expanding faster than working capital.

Third, other concerns are attracted to receivables financing because it enables them to get funds needed for the conduct of their business on more favorable terms than are available on other bases. For example, the company may be small and undercapitalized and find that the additional financing which it needs can be had through sale or pledge of receivables without diluting the ownership with additional equity funds or borrowing for long periods. This is an especially strong consideration if funds are needed to finance short-period increases in volume. Also, there may be cases in which the receivables loan is more attractive if it can be obtained on terms that do not require endorsements of officers.

Fourth, some borrowers prefer receivables financing because of its convenience. As a kind of revolving credit it has the advantages of the semi-automatic features of this type of financing as contrasted with the straight loan payable in one sum at maturity or in instalment payments. The arrangement is such that the loan balance varies automatically with the volume of receivables assigned and the rate at which collections are made; thus the loan balance is not a subject of periodic negotiation.

Finally, there may be cases in which funds obtained through the sale or assignment of accounts receivable are more economical than funds acquired on any other basis. Again, this results from the revolving character of receivables credits and the fact that the loan balance, on which interest is charged, is geared closely to the amount of funds actually in use. If credit needs vary widely over short periods a receivables

loan may produce a lower interest cost for the borrower than a nominally lower rate that is charged on a straight loan, against which the borrower may accumulate a substantial deposit balance. This possibility of greater economy in receivables borrowing depends, of course, on the immediate application of collections on assigned receivables to the client's loan balance. We may conclude, therefore, that the services of non-notification receivables financing agencies—whether commercial finance company or commercial bank—may be used for any one or more of several reasons; its users may be able to borrow on other bases but prefer receivables financing for the reasons cited, or they may be companies whose financing needs could not be adequately met on any other basis because their financial positions have been partly, perhaps seriously, impaired.

When accounts receivable are sold or assigned without notification the business demand appears to be mainly for the use of funds. This is in sharp contrast to factoring for in this case the client demands, in addition to availability of funds, a credit approval and collection service and release from the carrying of credit risks. In non-notification financing the credit collecting and risk-bearing functions disappear and, to a certain extent, the credit appraisal function also. The fact that the demand is primarily for funds and that these funds are, in most cases, relatively costly as compared to those obtained on other bases, suggests that concerns of relatively weak financial position comprise the bulk of non-notification clients. Thus, while not universally true, it is generally the case that concerns borrowing on a non-notification basis present the financing agency with higher-than-average risks and higher-than-average servicing costs; risk-limiting devices are adopted and rates are set so as to compensate for this fact.

One of the reasons for the development of textile factoring was the need for guidance on questions of style and of merchandising in general, that is, for services going beyond the advancing of funds. In non-notification financing this sort of service was subordinated to the purely financial function but

in recent years there has been a marked tendency for the financing institution to supply the borrower with general management counsel, frequently on some fairly formal basis. Concerns unable to borrow from the usual banking sources at normal banking rates are often in need not only of funds but also of management advice and guidance. Provision of such aid is therefore an important function of the commercial finance companies and has been turned by them into an effective argument for the use of their facilities; some have established special divisions or subsidiaries to supply management counsel to clients. While the demand for this particular service was not the primary force accounting for the emergence of these companies, many of them now find this one of their most important supporting functions.

Commercial Bank Activity in Receivables Financing

The widespread activity of commercial banks in the field of receivables financing is of recent origin, dating from about 1933, and has been stimulated mainly by a desire to increase revenues through additional outlets for funds. The presence in the banking system, over the recent past, of substantial amounts of unused lending capacity and declining returns on bank assets has had the effect of stimulating the interest of commercial banks in different types of financing, particularly if these held out prospects of higher-than-average rates of return. An example of this is the interest of commercial banks in consumer instalment credit.[6] The same conditions that have influenced banks to develop lending in this field have stimulated commercial banks to undertake accounts receivable financing. Interviews with bank officers have invariably indicated that the bank became interested in receivables financing as a means of providing a new use for funds that should be both profitable to the bank and helpful to the borrower.

One of the most important of the conditions affecting the activity of commercial banks in receivables financing has been the legal basis on which the arrangements are made. These legal conditions relate mainly to the validity of the lender's

[6] See John M. Chapman and Associates, *op. cit.*, Chapter 1.

lien on accounts; in most states they merely offer hindrance to bank participation in receivables financing but in some they have been a definitely retarding influence. The position of the financing institution depends on whether the open accounts are purchased or taken on assignment as collateral security for an extension of loan credit; and, ultimately, this distinction depends on whether the accounts are taken with or without recourse on the client. The procedure of buying the open accounts under a purchase and sale agreement, without recourse for credit losses on the vendor of the accounts, is recognized as providing the purchaser with unquestioned title to the accounts; it is this procedure that is followed by factoring companies. Commercial finance companies doing a non-notification business are divided in their procedure; some take receivables on assignment as collateral against a loan balance but the great bulk of this type of financing is done under the purchase and sale type of agreement. However, the fact that trade debtors are not notified and that collections must be made by the client makes it necessary for the financing institution to have recourse on its client for credit losses on purchased receivables; this fact of recourse has generally led to the transaction being construed by the courts as a loan rather than as a purchase.[7]

Bank practice in non-notification financing varies with the laws of the state in which the business is conducted. In some cases the accounts are acquired under a purchase and sale agreement; in other cases the transaction is completed as an

[7] As regards the legal position of the factor and the commercial finance company, an important question arises from the fact that, in addition to purchasers of open accounts, advances are frequently made to clients on the pledge of merchandise inventory. In the case of the factor, the validity of the lien on merchandise inventory is established, where the merchandise is held in New York State, by the New York State law, dealing with factors' liens. The lien is acquired in this case by recordation with the County Clerk and by posting, on all points of ingress to the customer's premises, signs indicating that the company is factored by the specified factoring company. Some problems surround advances on goods held outside of New York State. However, in such cases the financing agency might establish its lien by placing goods in a public warehouse and taking a receipt thereon, through the acquisition of a field warehouse receipt whenever this is feasible or by the establishment of a trust receipt arrangement.

assignment of collateral to secure a loan balance. However, insofar as the bank has recourse on the vendor of the accounts it would seem that, in either case, the transaction would be viewed, in law, as an assignment. This is of crucial importance to the development of bank interest in receivables financing because of the questions that surround the validity of such assignments in different states and the procedures that must be followed in order to establish a valid lien.

The main question involved is whether the lending institution, in the event that the borrower is involved in bankruptcy, has a lien on the assigned accounts that is prior to that of the general creditors of the borrower. State laws differ widely in their definition of what constitutes a perfected lien. In some instances, as in Ohio, the lender's lien is perfected if an intention to take assignments of accounts from the borrower in question has been recorded with the county recorder. In this state the filing of an affidavit with the county recorder constitutes notice to all persons, except the obligors on the assigned accounts, that the borrower (transferor) intends to assign accounts to the lender (transferee) and gives to the latter a prior or paramount lien on the accounts and on any proceeds arising therefrom. The affidavit is valid for three years and is renewable.[8] Likewise, in Michigan the courts have held that a "continuing assignment" of all the assignor's receivables can be made and that the assignee's lien is perfected thereon even though no notice is given to trade debtors. In fact, however, some Michigan banks notify other creditors of such an assignment mainly in order to protect against abuse of the privileges afforded by the law. These favorable legal conditions do not prevail in all states. Lenders located in states where perfection of lien is easily established may refuse to take assignments of receivables of customers located in a state having an unfavorable law on the ground that the transaction may be viewed as having been effected in that state.

[8] House Bill No. 533, *An act to regulate the assignment of accounts receivable by providing for the filing and indexing of an affidavit setting forth the intention of the transferor to assign the same and by prescribing the form and the effect of the assignment thereof.* Passed May 15, 1941; approved June 5, 1941.

Thus, from the point of view of the commercial bank, the critical point is whether an assignment can be held as valid if the trade debtor is not notified thereof. The Ohio recordation statute reviewed above grants this priority but in some states, for example in Tennessee, it is agreed that notification is essential. In other states the whole question is open to doubt. Since most concerns desiring to borrow on open accounts do not want their customers notified of the assignment of their accounts, this situation has tended to restrain commercial banks from entering the field of open accounts financing. The fact that their position is likely to be vulnerable in receivership proceedings has meant that commercial banks will generally lend money on this basis only to concerns that have a relatively strong financial position, or at the least are in no immediate danger of business failure.[9] Since this type of financing is often sought by concerns that are in a relatively weak financial position and are therefore unable to obtain any or adequate funds on other bases, commercial banks in states having unfavorable laws are seriously limited in the scope of their operations.

The legal hindrances to non-notification open accounts financing, as the banks conduct the business, are traceable in large part to the revision of the Federal bankruptcy laws made in 1939 under the Chandler Act of that year and to the interpretations placed upon Section 60(a) of that Act. On this point the language of the Chandler Act is as follows: " . . . a transfer shall be deemed to have been made when it became so far perfected that no *bona fide* purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under Chapter 10, 11, 12 or 13 of this Act, it shall be deemed to have been made immediately before bankruptcy." [10]

[9] The bank will, in most instances, retain an option to notify trade debtors but will do so only if it feels that the borrower is in danger of insolvency.

[10] Federal Code Annotated, Title 11, sec. 96(a). On the effect of the Chandler Act on the assignment of accounts receivable see 26 Virginia Law Review 168 (December 1939) and 34 Illinois Law Review 538 (January 1940).

The Act further provides that if the transfer was made four months or less before bankruptcy it is a voidable preference.

The question arises, then, as to what steps must be taken to perfect a transfer in order to avoid having the transaction viewed, in receivership, as a voidable preference.[11] As indicated above, this question is determined by the law of the state in which the transaction takes place. Opinions as to what is necessary to perfect a lien vary a good deal, but it seems to be the consensus that, whether trade debtors are notified or not at the time of the assignment, ledger books must be stamped so as to indicate which accounts have been assigned and to identify the assignee, and that the transferee must obtain dominion over the proceeds arising out of the assigned accounts, depriving the assignor of "unfettered use" of collections.[12] In order to complete these steps the financing agency necessarily incurs costs not associated with other types of loans but this is apparently not as important a restraint upon bank participation in receivables financing as is the law regarding notification. Interviews with bank credit officers have made it very clear that in those states requiring notification, and in those where doubt as to the legal situation makes notification a necessary precaution, the development of this type of bank lending has been definitely restrained.[13]

Another consideration affecting the entry of commercial banks into the field of receivables financing has been the atti-

[11] Preference means a transfer whereby the rights of one creditor are advanced over those of other creditors. This would generally arise when the transfer was made to satisfy an antecedent debt thus leading to a diminution of the estate of the transferor. See Adams *vs.* City Bank and Trust Co. of Macon, Georgia, *in re* General Box Co., Inc., Circuit Court of Appeals, Fifth Circuit, November 15, 1940.

[12] These conditions are discussed in 25 Marquette Law Review 28 (December 1937) and 44 Yale Law Review 639 (February 1935).

[13] There are, of course, other restraining conditions not the least of which is the relative scarcity of personnel qualified to carry on an open accounts department and the fact that, as in the case of most operations involving a large number of small transactions, it is generally stated that a substantial volume of business is needed before it can be done profitably. Finally, there is still a rather deep-seated antipathy toward the assignment of accounts based on a general, though often exaggerated, feeling that this represents the last resort of an unsuccessful, undercapitalized enterprise.

tude of bank supervisory and examining officials. It is difficult, however, to state definitely either the character or the extent of the influence that supervision has had on commercial bank activity in this field. This is due in part to the fact that we have not one but a number of bank supervisory agencies and also to the fact that there is no standard or uniform policy followed by bank examiners in appraising particular accounts receivable loans. A general agreement as to the procedures and standards that are to be followed in appraising loans of the receivables type does tend to emerge, however, among the bank examining forces. This uncodified yet generally accepted policy, the outlines of which can be stated here, develops in connection with all the various kinds of loans and is formulated over a period of years out of the personal contacts and cooperative work of the examining force.

At the present time the attitude of the bank examiner seems to be affected mainly by past experience with loans secured by assignments of accounts receivable. Since commercial banks have usually placed loans on this basis as a means of working out of an unfavorable situation, the bank examiner often approaches an accounts receivable loan with an initial suspicion that the credit is a weak one. The extent to which this is the case will of course affect the examination process but in any event there are certain points which almost every appraisal of a receivables loan includes. First, the examiner determines whether the bank has assembled an adequate file of relevant credit and financial information on the borrower. Second, the character and quality of the assigned accounts are appraised, with special attention given to the borrower's past collection experience with the trade customers indebted on the assigned accounts. Third, the bank must show that it has established a valid lien on the assigned accounts. This is particularly important if the examiner feels, on examining the financial statement, that there is an inherent weakness in the borrower's position. In practice, such a judgment might lead to a suggestion that the trade customers be notified. Fourth, recognizing that receivables financing is a technical field of lending involv-

ing unique credit hazards, the bank examiner is also influenced by his judgment of the bank's demonstrated ability to conduct this type of lending business. The examiner's opinion on this question ordinarily has considerable influence on the examination process. Finally, account is taken of the collateral margin that the bank has reserved for itself on the loan and whatever other protective measures may have been adopted. The examiner's final judgment emerges as the net result of a consideration of all of these points although the emphasis may be placed on different aspects, in specific cases and in specific banks.

The influence of bank examination on bank participation in receivables financing depends mainly on the relative emphasis that the examiner places on the two main elements in this credit appraisal process—the financial position of the borrower and the quality of the assigned receivables. The examiner may take the position that the loan should be judged as an unsecured credit, or at least that the assigned receivables be viewed as of secondary importance as compared with the credit standing of the borrower. On the other hand, the loan may be appraised with primary emphasis on the collateral security, or at least with equal emphasis on the credit standing of the borrower and on the quality of the assigned accounts. The direction in which the weight of the examination appraisal is thrown necessarily has considerable effect on bank participation in receivables financing because many concerns borrowing on this basis are admittedly of relatively weak financial position, even though their receivables may represent sales to customers of high quality. If the examiner lays principal stress on the creditworthiness of the borrower and regards the assigned accounts as of secondary importance this will tend to restrain bank participation, and vice versa.

2

The Volume of Accounts Receivable Financing

THE PRINCIPAL AGENCIES supplying funds to business enterprises on the basis of open accounts receivable are factoring companies, commercial finance companies and commercial banks. The general nature of the factors' functions has already been suggested; the term commercial finance company will be used to signify non-bank agencies purchasing or taking assignments of open accounts on a non-notification basis, generally with recourse on the borrower. Many of these companies engage in other activities, such as the purchase of instalment sales contracts, but we shall limit this study to their open accounts financing. While all three of these agencies overlap at some points with regard to the services they offer and the types of clients they serve, it will be convenient to develop estimates of the volume of receivables financing transacted and describe the institutional character of the market in terms of this classification of agencies, particularly in view of the fact that previous estimates have been based on this same division. The agencies will be dealt with in the order of their historical development as receivables financing institutions.

It has been estimated that the total volume of receivables financing transacted in 1940 amounted to roughly $2 billion and that the 1941 volume reached $2.6 billion. Of the 1940 volume approximately $800 million was conducted by factoring companies, $411 million by commercial finance companies and $826 million by commercial banks. It is estimated that the 1941 volume was divided as follows: $1,150 million by factors, $536 million by commercial finance companies, and $952 million by commercial banks. The procedures followed in deriving these estimates are described in this chapter.

Factors

Various estimates have been made of the growth and present magnitude of the business conducted by factoring companies, the first of the agencies to engage in receivables financing. It is probable that these estimates overstate the volume of factoring because of the difficulty in drawing a clear line between this type of financing and receivables financing conducted on a non-notification basis. One writer estimates the volume of sales factored during 1938 at about $1 billion.[1] This writer places the volume of sales factored in 1917 at $200 million and at $550 million for 1933. Another estimate, submitted to the National Recovery Administration, contains annual volume figures for the period 1928-33 inclusive. The estimate was based on the volume of business transacted by a number of factoring companies, varying from 16 to 20 over the period; in view of the concentration of factoring in the few large companies the series probably represents at least 90 percent of the total volume of old-line factoring. It places the 1928 factoring volume at $345 million (16 companies) and the 1933 volume at $543 million (20 companies).

After 1933, data are not available on the volume of business conducted by all the factoring companies covered in the NRA estimate, but information is available for most years on the volume of seven of the leading factors. In 1933 the volume of sales factored by the seven companies made up about two-thirds of the volume reported for the 20 companies represented in the NRA estimate. Changes in the volume for these seven companies have been used as a basis for industry estimates on the assumptions that (a) their share of the total factoring volume has not changed substantially over the period 1933-41, and (b) that the NRA estimate for 1933 represents 90 percent of total factoring volume in that year.[2]

[1] George Mills, "Remarkable Growth of the Factoring Industry: Its Expansion into New Fields," *The Annalist* (April 1, 1938) p. 452.

[2] The latter assumption is strengthened by the fact that the Mills estimate and the NRA estimate agree for 1933. See Appendix A for a statement of the method used in making the National Bureau estimate of factoring volume.

The results of this estimating procedure, shown in Table 1, indicate that factoring volume has about doubled since 1933. The 1941 volume (nearly $1,150 million) shows an increase of almost 25 percent over the 1940 volume (nearly $800 million [3]).

Table 1—ESTIMATES OF THE VOLUME OF ACCOUNTS RECEIVABLE FINANCED BY FACTORING COMPANIES, 1928-41
(*dollar figures in thousands*)

Year	Volume of Sales Factored by Seven Factors [a]	NRA Estimate [b]		National Bureau Estimate of Total Factoring Volume [c]
		No. of Factors Included	Volume	
1928	..	16	$344,980	..
1929	..	17	485,220	..
1930	..	17	505,450	..
1931	..	17	490,750	..
1932	..	18	436,830	..
1933	$369,797	20	542,510	..
1934	434,636	..	..	$700,000
1935	451,015	..	..	726,000
1936	495,085	..	..	797,000
1937	536,184	..	..	863,000
1938	423,038	..	..	681,000
1939	464,724	..	..	748,000
1940	490,549	..	..	790,000
1941	710,205	..	..	1,143,000

[a] Includes James Talcott, Inc.; Mill Factors Corporation; Commercial Factors Corporation; Meinhard Greeff and Company, Inc.; William Iselin and Co., Inc.; Textile Banking Company, Inc.; and Edmund Wright Ginsberg Corporation. See Appendix A for a statement of the method used in making estimates for certain of these companies.

[b] See Owen T. Jones, "Factoring," *Harvard Business Review* (Winter, 1936) p. 187.

[c] This estimate was derived as follows: the NRA estimate for 1933 was raised by 10 percent and its ratio to the 1933 volume of sales factored by the seven major factoring companies in column 1 (1.61) applied to the sales of these seven factors for the years 1934-41, inclusive.

Commercial Finance Companies

The second area of receivables financing in point of historical development is the non-notification financing of open ac-

[3] This estimate of 1940 volume is exactly the same as that given by Roy A. Foulke, *The Sinews of American Commerce* (Dun & Bradstreet, Inc., 1941) p. 190. In view of this exact agreement it should be indicated that the estimates were arrived at independently.

counts receivable by commercial finance companies. There are no data sufficiently broad in coverage to provide a basis for estimating the growth of receivables financing of this type over any period, but it is possible to make a fairly reliable estimate of its present volume.

The outstanding notes and open accounts receivable arising out of non-notification financing are available for year ends for 1940 and 1941 for seven major commercial finance companies [4] as is also the volume of receivables acquired during 1940 by three of these companies. Estimates of the 1940 and 1941 volume of non-notification financing transacted by the seven major commercial finance companies were derived by applying to their year-end outstandings an average ratio of volume to outstandings. The ratio used was based on a study of published figures of three companies and unpublished turnover data for two other companies. On this basis it was estimated that the 1940 volume for the major companies was $346 million and the 1941 volume $466 million.

In addition to these companies there are a number of smaller sales finance companies indicating varying amounts of open accounts receivable, both of the old-line factoring type and the non-notification type, in their financial reports at the end of 1939. These data were raised to an estimate for 1940 year-end outstandings by applying to them the percentage increase shown by the seven major factoring companies covered in Table 1. This produced an estimate of 1940 year-end outstandings of approximately $1.5 million. On the basis of the ratio of outstandings to volume which was used to estimate volume for the major commercial finance companies, this amount of outstandings represents a 1940 volume of $15 million for these smaller companies. In view of the increased volume transacted by the major commercial finance companies

[4] These include Commercial Credit Company, a national company, and the following regional companies: American Business Credit Corporation, Bankers Commercial Corporation, Finance Company of America at Baltimore, Walter E. Heller and Co., Manufacturers Trading Corporation and Seaboard Commercial Corporation.

in 1941 it is probable that these smaller companies did approximately $20 million of non-notification financing in 1941.

Finally, there are a number of relatively small local companies engaging primarily in non-notification financing. There is little information to be used in making an estimate of their number and of their average annual volume of business but interviews with various experienced members of the industry suggest that they number about 100 and that their average annual volume would be approximately $500,000 each. This would place the annual volume of these companies at about $50 million; this estimate will be used for both 1940 and 1941.

Summarizing these estimates, the total 1941 volume of the non-notification branch of receivables financing is about $536 million divided as follows: major national and regional commercial finance companies—$466 million; regional and local sales finance companies—$20 million; local commercial finance companies—$50 million.

Commercial Banks

It remains to estimate the volume of receivables financing transacted by commercial banks. In this case also, the financing is almost exclusively of the non-notification type athough there is at least one bank that conducts a "factoring" business, that is, notification, non-recourse receivables financing. In order to make an estimate of the present quantitative importance of their accounts receivable financing, a sample of commercial banks was surveyed by questionnaire.[5]

The results of this survey, presented in Table 2, show that the ratio of accounts receivable loan balances to total loans and discounts was lowest—.2 percent—for the 32 reporting banks in the largest size group, namely those with total deposits of over $50 million. The relative importance of accounts receivable loan balances was somewhat higher in other size classes of banks but in no case did the ratio rise above 2 percent of total loans and discounts. Applying the ratios

[5] See Appendix B for a statement of the nature of this sample.

Table 2—ESTIMATE OF TOTAL OUTSTANDING ACCOUNTS RECEIVABLE LOAN BALANCES OF COMMERCIAL BANKS AS OF DECEMBER 31, 1940, BY DEPOSIT SIZE OF BANK (*dollar figures in thousands*)

Deposit Size of Bank[a]	*Banks Responding to Questionnaire Survey*				*Total Loans and Discounts of All Insured Commercial Banks*[b]	*Estimate of Total Accts. Receivable Loan Balances Outstanding at End of 1940*
	Number	Total Accts. Rec. Loans Outstanding	Total Loans and Discounts	Accts. Receivable Loans in % of Total Loans		
$5,000 or less	196	$1,001	$134,352	.7%	$4,827,719	$33,794
5,000-10,000	39	1,003	89,679	1.1	1,266,521	13,932
10,000-50,000	59	8,029	404,398	2.0	2,661,226	53,225
Over 50,000	32	6,432	2,717,821	.2	8,281,876	16,564
ALL INSURED COMMERCIAL BANKS						$117,515

[a] Each size class is exclusive of the lower limit and inclusive of the upper.
[b] Federal Deposit Insurance Corporation, *Annual Report, 1940,* p. 171.

calculated for reporting banks to the total loans and discounts outstanding at the end of 1940 in all insured commercial banks produces an estimate of the accounts receivable loans of commercial banks, outstanding at the end of 1940, of $118 million. In view of the fact that total loans and discounts of banks were about 15 percent higher at the end of 1941 than at the end of 1940, it is estimated that there were about $135 million of bank receivables loans outstanding at the end of 1941. On the assumption that these loan balances are outstanding, on the average, for about 50 days,[6] it is estimated that the 1940 annual volume of commercial bank accounts receivable financing was about $826 million and the 1941 volume about $952 million. This places commercial bank receivables financing at a level roughly equal to that conducted by factors and at about twice the amount conducted by commercial finance companies. Adding these estimates we arrive at a total of receivables financing conducted during 1940 by all three types of agencies of roughly $2 billion; the total for 1941 was approximately $2.6 billion.

[6] This assumption is supported by evidence introduced in Chapter 5.

3

Institutional Facilities

CONSIDERABLE INFORMATION is available on the growth and present status of factors and commercial finance companies but data on the receivables financing activities of commercial banks have until recently been almost wholly lacking. A questionnaire survey, conducted in mid-1941 by the National Bureau of Economic Research, provides information on the frequency with which banks of different sizes and locations are engaged in receivables financing and the extent of their interest in this field. The Reconstruction Finance Corporation and the Federal Reserve banks have extended credit on the security of assigned accounts receivable,[1] as have some industrial banking companies, but these agencies are of minor quantitative importance in receivables financing and our discussion is therefore limited to factors, commercial finance companies and commercial banks

Factors

There are several reasons for the concentration of the factoring business in New York City; of primary importance is the fact that the business obtained an early start in New York. The antecedents of many factors were representatives of foreign mills who located in New York because of its position in import trade and its prominence as a textile distributing center and sales market. As the functions of some of these houses became more nearly financial in character they retained, with advantage, their close proximity to the selling agencies. Concurrently, there developed in New York City a group of credit-

[1] See National Bureau of Economic Research (Financial Research Program), *Term Lending to Business,* by Neil H. Jacoby and Raymond J. Saulnier (1942) pp. 61 and 63.

rating and other service agencies that made the functioning of the factoring company in that city more economical.

A relatively small number of companies conduct the bulk of the factoring business; information is not available on all of these but a good deal is known of the history of the principal ones. One of the largest was founded in 1808, another in 1854. Some of the present large factoring companies represent consolidations of a number of companies. One consists in part of concerns established in 1828, 1838 and 1893, while another company has consolidated two concerns, one formed in 1857, the other in 1898.

The consolidation movement in factoring began in the latter part of the 1920's and continued through the first half of the thirties. The movement started in 1928 with the acquisition of Peierls, Buhler & Co., Inc. by Commercial Investment Trust Corporation. In 1929 Commercial Investment Trust Corporation acquired another factoring company, Frederick Vietor and Achelis, Inc. and the factoring subsidiaries were merged in that year to form Commercial Factors Corporation. Two more concerns, Schefer, Schramm and Vogel, and Bachman, Emmerich and Company, were absorbed by Commercial Factors Corporation in 1930 and 1936, respectively. Commercial Investment Trust Corporation has two more separately operating factoring subsidiaries, William Iselin and Company, Inc. and Meinhard Greeff and Company, Inc. Of these William Iselin and Company, Inc. was acquired in 1931 as the factoring business of William Iselin and Company; Meinhard Greeff and Company, Inc., was formed in the same year as a consolidation of Morton H. Meinhard and Company, Inc. and Greeff and Company, Inc.

The acquisitions of factoring subsidiaries by Commercial Credit Company involved no consolidations. This company acquired Edmund Wright Ginsberg Corporation and Textile Banking Company, Inc. in 1933, these companies continuing to operate separately as subsidiaries. No further changes have taken place among the larger factoring companies, and, with the exception of John P. MacGuire and

Company, Inc. which was formed in 1934, no new companies have come to assume major importance in recent years. The consolidation movement was over by 1936.

Factoring companies tend to be large as compared to many of the commercial finance companies engaged in non-notification financing. However, in discussing the relative size of factors it should be recognized that some of the largest factors are subsidiaries of Commercial Credit Company which in turn does a non-notification financing business. It should also be pointed out that it is difficult to make a choice between total assets and annual volume as a measure of size. The turnover of receivables is so rapid that total assets is not a very satisfactory measure. On the other hand, if a company has a relatively large proportion of its assets in advances to manufacturers, this will tend to reduce its relative size standing when annual volume of receivables purchased is the measure used. It will be necessary therefore to use both measures where the information is available.

The largest firms in the factoring field are Commercial Factors Corporation and William Iselin and Co., Inc., both subsidiaries of Commercial Investment Trust Corporation. Each of these companies had a 1941 volume of about $140 million; their total assets as of the end of 1941 were $30 and $25 million respectively. James Talcott, Inc. did approximately $110 million of factoring in 1941 on assets of $17.5 million and Textile Banking Company had a 1941 volume of about $70 million on assets of $12 million. It is estimated that in addition to these there are at least five companies with annual volumes of between $25 and $50 million although this is based on rather incomplete information and, in part, on assumptions concerning changes in volume between 1932 and 1941.[2]

Other factoring companies have an annual volume of less than $25 million, most of them about $10 million, but at this

[2] This does not account for John P. MacGuire and Company, Inc., for which information is not available. This company is one of the largest factors and is thought to have a volume of approximately $100 million annually.

size level it becomes increasingly difficult to distinguish between the old-line factoring company and agencies of different types. In this group there are concerns that function in part as factors but also as non-notification financing companies, that is, as commercial finance companies in the terminology of this study. Others combine financing with selling functions and it is impossible to say whether they are best described by the one function or the other.

The general financial characteristics of factors are shown in Table 3 which gives data for a changing number of companies for the period 1925-41. Because of the changing identity of companies in the composite it is not possible to use this table as an unquestionable indication of changes in financial structure, although certain general movements may be detected. First, it is noticeable that there has been very little change over recent years in the proportion of cash held to total assets, this remaining at about 10 to 12 percent. Second, the data show that factoring assets are predominantly in open accounts receivable at the present time and that there has been a tendency for these to increase relative to merchandise advances to clients. Factoring companies rent their quarters; thus cash, receivables and advances comprise the bulk of all assets. Among "other assets" are included investments in mills but these are not as important at present as was formerly the case. However, no information is to be had on the earlier relationships between factor and mill because the investments were held, for the most part, by companies organized as partnerships, and financial statements were not published.

From 1925 to 1940 the net worth of the factoring companies covered in Table 3 varied between 32 and 59 percent of total liabilities and fell to about 25 percent in 1941. The high figure for 1932 is somewhat abnormal and reflects the sharp decline in notes payable to banks which occurred at that time. It is clear that factoring companies have a substantial capital cushion in their business. Indeed, the capital account of the factoring companies is larger than that of sales

Table 3—PRINCIPAL ASSET AND LIABILITY ITEMS OF FACTORING COMPANIES, 1925-41, IN PERCENT OF TOTAL ASSETS [a]

End of Year	Number of Companies	Total Assets (000)	Asset Items			Liability Items			
			Cash	Accounts Receivable Purchased [b]	Merchandise Advances	Net Worth	Notes Payable	Due to Manufacturers and Others	Reserves for Losses
1941	5	$97,109	9.8%	80.0%	5.5%	24.6%	44.5%	25.8%	1.2%
1940	5	71,990	11.6	74.0	12.6	32.5	39.4	23.6	1.5
1939	6	73,710	11.1	76.2	11.0	37.7	32.9	24.9	1.5
1938	6	68,012	12.3	75.1	10.4	43.3	25.1	27.5	1.9
1937	6	78,536	12.4	70.6	15.9	38.3	38.9	18.3	1.6
1936	5	67,691	9.6	81.1	7.9	35.3	29.0	30.6	1.5
1935	4	48,481	10.0	74.0	14.6	35.5	29.4	29.6	1.3
1934	5	46,139	15.4	70.3	13.4	43.9	22.1	28.6	1.4
1933	4	38,182	12.2	68.1	19.1	42.9	29.1	23.2	1.4
1932	4	24,000	19.8	59.9	17.8	59.2	8.4	27.3	1.3
1931	4	36,589	14.1	61.3	19.4	49.4	26.6	18.8	1.5
1930	4	48,913	12.1	62.3	21.7	37.7	33.7	20.2	1.2
1929	3	45,569	11.5	54.1	31.1	32.2	44.8	8.9	1.3
1928	3	49,700	11.7	51.6	31.1	33.8	40.0	11.4	.7
1927	2	16,376	12.2	54.1	23.8	41.2	46.7	8.9	.3
1926	2	16,219	11.6	52.0	26.4	40.9	45.0	11.0	.3
1925	2	15,695	12.1	55.6	22.5	40.8	49.1	7.4	.3

[a] Based on data made available by the National Credit Office, Inc., and on reports to the Securities and Exchange Commission. Distributions do not add to 100 percent because of exclusion of "other assets" and "other liabilities."
[b] Net of reserves for discount but not of amounts due clients.

finance companies and much larger than that of commercial banking institutions.[3]

Table 3 shows that factors are important users of bank credit. Most of the factors borrow on the basis of unsecured notes, having lines of credit established with several banks and being generally regarded as of excellent credit standing. The larger factors also have ready access to short-term funds through sales of open market paper. Bank lines are rarely used up to their full extent, the factors allowing themselves considerable margins for seasonal peaks and for unforeseen contingencies. It is not at all easy to estimate the extent of the dependence of factoring as a whole on the banking system because the only data available on the ratio of notes payable to total assets of factoring companies are for year ends and do not reveal other, perhaps more active, periods. However, on the basis of year-end data it may be estimated that a factoring volume of $800 million a year would require an investment of about $150 million in total assets and that this, in turn, would involve a year-end indebtedness to banks of about $60 million. The factoring company has depended mainly on short-term funds so that borrowing may be expanded and contracted with seasonal and cyclical needs and, so far as can be ascertained, has not to date had recourse to bond financing.

It can be seen in Table 3 that merchandise advances have as a rule been amply covered by the factor's capital account. This is certainly true of the years since 1930 although in 1928 and 1929 these advances were nearly equal to the aggregate net worth of the companies covered. Another test that is often put to the balance sheet of a factoring company is the relation of short-term receivables to current debt. At the present time, short-term assets are more than twice as large as the factor's bank indebtedness at year end.[4]

[3] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices,* by Wilbur C. Plummer and Ralph A. Young (1940) p. 63.

[4] The item notes payable to banks includes outstanding open market paper but the data do not permit separation.

The acquisition of factors by the large sales finance companies seems to have produced no consistent relation between parent and subsidiary as regards borrowings. Although borrowings from parent companies depend on internal relationships and policies and do not necessarily reflect the subsidiary company's needs for funds, it seems reasonable to assume that the parent companies are more important sources of funds during the active factoring seasons than is evidenced in year-end statements.

Every factoring company's balance sheet carries an item comparable to the item "due to manufacturers and others" contained in Table 3. This mainly represents amounts that have not been withdrawn by clients from the credits established when receivables were cashed and includes other credit balances, of lesser amount, that may be outstanding. Formerly it was a general practice to pay interest on these balances at 6 percent per annum but of late some few cases have called for no interest, a 2 percent per annum rate or some other rate below 6 percent, depending on the special circumstances. For a small company with limited borrowing capacity these balances might be an important source of funds; actually they are important for all companies in that they provide a margin for the absorption of deductions in the value of cashed receivables arising out of merchandise returns and other offsets for which the factor is not responsible. It is clear that this item has tended to grow in relation to total assets since 1929 and that merchandise advances, which involve more risk than other financing activities of the factor, have tended to decline in relative importance as an asset. Finally, it should be noted that the loss reserves established by factoring companies have always been under 2 percent of total assets and that there has been a tendency for these reserves to increase.

The essential similarity in the balance sheet structures of factoring companies, when compared individually, is shown by Table 4. The principal points of difference revealed in this table relate to merchandise advances; one company had a much smaller proportion of its total assets invested in these

Table 4—PRINCIPAL ASSET AND LIABILITY ITEMS OF FIVE FACTORING COMPANIES, DECEMBER 31, 1941, IN PERCENT OF TOTAL ASSETS [a]

Company	*Asset Items*			*Liability Items*			
	Cash	Accounts Receivable Purchased [b]	Merchandise Advances	Net Worth	Notes Payable	Due to Manufacturers and Others	Reserves for Losses
A	7.2%	78.6%	5.8%	24.7%	48.6%	21.9%	1.1%
B	9.4	78.5	5.4	21.8	38.6	33.2	1.2
C	16.0	61.7	1.4	28.7	38.2	29.8	1.4
D	7.9	81.0	8.5	23.5	48.3	22.9	1.4
E	11.0	81.2	8.1	25.2	52.1	16.1	1.2
ALL COMPANIES	9.8%	80.0%	5.5%	24.6%	44.5%	25.8%	1.2%
Amount (000)	$9,562	$77,685	$5,355	$23,852	$43,165	$25,096	$1,210

[a] Based on data made available by the National Credit Office, Inc., and on reports to the Securities and Exchange Commission. Distributions do not add to 100 percent because of exclusion of "other assets" and "other liabilities." All assets of the five companies total $97 million, approximately 50 percent of all assets in use in the old-line factoring industry at the end of 1941.

[b] Net of reserves for discount but not of amounts due clients.

advances at the end of 1941 than did the other four companies. It should be indicated that the companies included in Table 4 are large factors and are the same companies whose balance sheets were combined for the 1941 data given in Table 3.

Commercial Finance Companies

The first company organized to take assignments of open accounts receivable on the non-notification plan was the Mercantile Credit Company organized in Chicago in 1905.[5] Only a few of the larger finance companies were active in this field before 1920. Commercial Credit Company, the largest of the non-notification companies, was established in Baltimore in 1912, four years after the organization of the Manufacturers Finance Corporation. The latter company is described as the first company to do a non-notification receivables financing business in the east.[6] The Finance Company of America at Baltimore, Inc. was established in 1921 to take over the assets of Capital Service Corporation, which had been organized as a commercial finance company in 1917. Although it did not begin open accounts financing until 1925, Walter E. Heller and Co. was organized in 1920, succeeding Heller, Marks and Company, Inc., established in 1919. Two other companies, Bankers Commercial Corporation and Seaboard Commercial Corporation, both of New York, were established before 1920, the former in 1904 as Fidelity Contract Corporation and the latter in 1916 as Finance Service Company, Inc., but neither began accounts receivable financing until much later. Seaboard Commercial Corporation's interest dates from 1937 and that of Bankers Commercial Corporation from about 1939. Manufacturers Trading Corporation, which was organized in 1929, and American Business Credit Corporation, organized in 1937, have been from their outset interested mainly in open

[5] For a brief discussion of this early history see *The Economics of Instalment Selling*, by E. R. A. Seligman (New York, 1927) Vol. II, pp. 35-37.

[6] See *Annual Report to the Stockholders*, Commercial Credit Company, December 31, 1940. Manufacturers Finance Corporation was acquired by the Commercial Credit Company in 1938. At that time its annual volume was around $35 million.

accounts receivable financing; in certain other companies receivables financing has displaced, or been added to, automobile sales financing or income-producing equipment financing.

In other cases, however, open accounts financing on a non-notification basis has been displaced by other activities. This has been the case with Commercial Investment Trust Corporation, which was established in 1908 as Commercial Credit Investment Trust mainly to do an open accounts receivable financing business but ceased doing this early in the 1920's and diverted its resources to the financing of instalment sales of automobiles and income-producing equipment. As pointed out in the preceding section, C. I. T. Corporation acquired factoring subsidaries in the period 1929-31, but these companies engage exclusively in the non-recourse purchasing of receivables, mainly of textile concerns, on a notification basis. Furthermore, there is evidence that some other companies are, as a matter of management policy, reducing the portion of their resources devoted to non-notification receivables financing, but these appear to be local or small regional sales finance companies.

Most of the smaller commercial finance companies are located in New York and Chicago, although some are to be found in other commercial centers. For the most part they were established in the last ten or fifteen years, but a few have been in business for as long as twenty years. Because of the risks attendant upon this type of financing, and particularly in view of the fact that the smaller companies tend to take the heavier risks, the mortality rate for these companies must be relatively high, but on this point there are no reliable data.

Although open accounts receivable financing is carried on by one company that has a large local branch organization with national coverage, the Commercial Credit Company, and by several regional companies, it is generally characteristic of these concerns that credit extensions and direct controls are exercised from a central office. Local branches are not used, as they are in automobile time-sales financing, for direct

and continuing contacts with clients. Key branches are used, however, for the origination of accounts and as regional field headquarters for auditing and credit investigations. These branches are important mainly for the fact that they increase volume and thus make it possible to utilize more efficiently the kind of central organization necessary for the curtailing of risks. Thus any unit, whether finance company or commercial bank, is at a disadvantage if it cannot originate in its immediate trading area a volume of business sufficient to carry the costs of a properly staffed receivables department. With few exceptions commercial banks operate as unit agencies in receivables financing and in the majority of cases they do not, as a matter of policy, go outside their natural trading area to acquire receivables clients.

In contrast to factoring companies, the large commercial finance companies conduct highly diversified financing activities. This will be illustrated below by an examination of the asset structures of the major companies. There is, however, a group of small local commercial finance companies specializing in the purchase, on a non-notification basis, of open accounts receivable although these companies may make loans on commodities, contracts, machinery and equipment. Finally, there are a number of intermediate-sized concerns that, like the larger commercial finance companies, engage in open accounts financing along with substantial interests in other lines, the most important of which are the financing of time sales of automobiles and other consumer durable goods and the financing of instalment purchases, by industrial users, of income-producing machinery.

The largest commercial finance companies may also engage in factoring, directly on a small scale, or indirectly on a larger scale, through subsidiary companies. It would be incorrect to assume that the nature of the diversification evidenced by commercial finance companies is in any way consistently related to size. It is important to recognize, however, that the services offered by these companies are very wide and that this

feature is considered by the companies as important to their own stability as well as to their power to attract clients.

The evidence of this diversification of activities is shown clearly in Table 5, based on balance sheets for six of the largest commercial finance companies engaged in non-notification financing and representing about one-half billion dollars in total assets. Of the combined assets of all companies, 75 percent were in receivables other than open accounts, although an examination of the individual companies will show that open accounts are much more important for some concerns than for others. The items represented in the "other receivables" classification are so numerous, and financial statement reporting is so varied in character, that no attempt is made here to break this item down. It can be stated, however, that the principal items are wholesale and retail automobile paper and wholesale and retail paper arising out of income-producing equipment financing. Table 5 also shows that, as in the case of factoring companies, cash and receivables constitute more than 95 percent of all assets of the commercial finance companies; in general, cash equals about 10 percent of total assets. This proportion of assets held in cash is somewhat higher than that characteristic of sales finance companies dealing predominantly in consumer credit and is just under that characteristic of factoring companies.

Commercial finance companies obtain their funds mainly from invested capital and bank borrowings. Table 5 also shows that these companies, as a whole, have a net worth of almost 16 percent of their total assets and that their notes payable at the end of 1941 were nearly four times the amount of their net worth. Most companies, however, had a notes payable to net worth ratio of about 2 to 1.

As was the case with many consumer finance companies in earlier years, the commercial finance companies formerly obtained funds through the issuance of collateral trust notes secured mainly by receivables acquired in their business operations. This practice has virtually disappeared, however, and has been replaced, for the larger companies that do the bulk

3332
S85A
H225

Table 5—PRINCIPAL ASSET AND LIABILITY ITEMS OF SIX COMMERCIAL FINANCE COMPANIES, DECEMBER 31, 1941, IN PERCENT OF TOTAL ASSETS [a]

Company	*Asset Items*			*Liability Items*			
	Cash	Open Accounts Receivable	Notes and Other Receivables	Net Worth	Notes Payable	Funded Debt	Reserves for Losses, Other Reserves and Clients' Equities
A	12.9%	33.8%	52.8%	21.9%	55.1%	..	20.9%
B	10.5	7.5	79.4	17.6	50.3	13.5%	12.5
C	11.1	8.2	78.7	14.8	61.3	10.3	8.9
D	11.9	68.4	19.2	21.0	46.8	4.7	25.2
E	10.2	42.4	47.1	16.1	42.9	14.3	23.3
F	9.5	38.3	49.0	21.3	43.7	18.2	14.7
ALL COMPANIES	11.1%	12.4%	74.4%	15.6%	59.0%	10.3%	10.7%
Amount (000)	$61,473	$68,861	$412,255	$86,380	$326,654	$56,780	$59,431

[a] Based on reports to stockholders and 10K reports to the Securities and Exchange Commission. Distributions do not add to 100 percent because of the exclusion of "other assets" and "other liabilities." All assets combined amounted to $554 million. Data for companies A and C are for June 30, 1941.

of the financing, by unsecured borrowings from commercial banks and other institutional investors. In short, their access to the general money market has improved with time, reflecting an improvement in their operating results. At present the major companies have very considerable borrowing power at most favorable rates.

It is more difficult to generalize concerning the practices of these companies in the maintenance of loss reserves and margins withheld from clients pending actual liquidation of purchased open accounts receivable. This is due principally to the fact that reserve practice varies with the type of receivable held, and the different companies hold varying proportions of the different types of receivables. It seems, on the basis of the incomplete evidence available, that the companies with the heaviest commitments in open accounts receivable tend to hold a larger proportion of their gross assets in reserve for losses and clients' equities than do the companies that are dependent on automobile or income-producing equipment financing for the bulk of their business.

While Table 5 provides examples of the financial structures characteristic of the larger commercial finance companies, and thus of those that conduct the major portion of the business, it does not represent the smaller and more numerous companies. About these very little is known since they are most frequently operated as partnerships or closely-held corporations and public information on their financial structure is therefore unavailable. In general, however, it can be said that they tend to specialize in purchasing open accounts receivable; some companies also make loans on equipment and inventory and others do some consumer financing, but these activities are definitely of secondary importance. The balance sheets of these smaller companies would doubtless show a higher concentration of assets in open accounts receivable than is displayed by companies included in Table 5.

Because of the size and organizational character of these relatively small companies, their borrowing capacities are doubtless more limited, by and large, than are those of the

companies shown in Table 5. One experienced operator in this field pointed out that the smaller companies use little borrowed money and that the ratio of debt to net worth would increase with the size of net worth. Thus a company with $200,000 net worth might achieve a debt to net worth ratio of ½ to 1, one with $400,000 a ratio of 1 to 1, one with $750,000 a ratio of 1¼ to 1, and the larger companies in this class might achieve ratios of 2 or 2½ to 1.

Commercial Banks

It has been noted that the interest of commercial banks in receivables financing has developed greatly in the recent past. An increasing number of banks have established special departments[7]; a much larger number, while not departmentalized for this purpose, have aggressively sought non-notification accounts receivable loans. Interviews with commercial banks in nearly all the leading centers east of the Mississippi and with bank supervisory officials indicate that this growth began around 1933 and has been particularly strong since 1935. In general, it corresponds to the growth in recent years of excess reserves and represents an effort on the part of commercial banks to extend credit into fields that, although new to them, appear profitable as contrasted with alternative uses of funds. This development has been parallel to, but somewhat later in appearance than, the growth of bank consumer instalment financing.[8]

As in the case of consumer financing, it can be said of accounts receivable financing that banks have always done a certain amount of it and perhaps nearly all banks do some at the present time. But it is important to distinguish regular participation in accounts receivable financing, undertaken on its own merits when originating loans, from the taking of subsequent assignments of receivables to support loans pre-

[7] These are variously named, for example, Commercial Service Department and Trade Finance Division.

[8] See National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit,* by John M. Chapman and Associates (1940).

viously made on some other basis. Nearly every bank has made this latter "work-out" type of loan at some time and, furthermore, every bank looks to open accounts receivable when making loans secured by other assets or when extending unsecured credit on the basis of a borrower's standing and financial statement. However, in discussing the participation of commercial banks in accounts receivable financing an effort has been made to include only those banks *regularly* engaged in making this type of loan on its own merits. Also, many banks have taken assignments of groups of time-payment accounts receivable originated by retail outlets and, more recently, have extended credit on the basis of assigned claims against the United States government in financing war contracts. Both these types of credit are excluded in the present study, since our focus of interest is on open accounts owed by business enterprises. In order to determine the extent of their participation in the field a questionnaire survey was made in July 1941 on accounts receivable financing.[9] This survey supplied the basis for the estimate of $135 million of outstanding accounts receivable loans in insured commercial banks at the end of 1941.

Further analysis of the questionnaire returns provides verification of the general observation that accounts receivable financing is most characteristic of banks in the larger centers of population and of the larger banks. Of the 327 responding banks, 89—approximately 1 out of 4—were regularly engaged in open accounts receivable financing. However, while 1 out of every 2 banks in cities of 500,000 and over reported receivables financing, this was the case with only 1 out of every 10 banks located in cities of less than 10,000. The survey revealed a regular increase in the ratios from banks in the smallest to those in the largest centers of population.

Questionnaire results also show that within this sample the larger banks were more frequently active in this field than the smaller banks; 1 out of every 16 banks with total deposits of $1 million or less reported regular activity in

[9] See Appendix B for a description of the survey and the questionnaire used.

receivables financing while every second bank with total deposits of over $10 million was so engaged. Finally, the survey showed that about 1 in every 4 banks with total deposits of between $1 million and $10 million was engaged in receivables financing. Further evidence that participation in accounts receivable financing is closely related to the economic character of the bank's trading region was provided by questionnaire returns showing that, among the banks covered in this sample, the frequency of commercial bank participation was highest in regions that are predominantly industrial in character. Thus, the Middle Atlantic, East North Central, East South Central and New England regions showed a frequency of 1 out of every 3 banks while, at the other extreme, the West North Central, South Atlantic and Mountain states showed frequencies of about 1 out of every 8 banks.[10]

The minor relative importance of loans made on the assignment of open accounts receivable is shown in Table 6; for all banks combined receivables loans amounted to only .9 percent of combined total loans and discounts. The number of banks covered in this survey is so small that very definite conclusions cannot be drawn as to the relation of size of bank to the ratio of receivables loans to total loans. The data indicate that for the very largest banks—those with deposits of over $50 million—these loans represented only .4 percent of total loans and discounts or approximately half their average index of relative importance. Furthermore there is very little difference in the indexes of relative importance for banks with deposits of $50 million or less, these ratios varying between 4.3 and 3.0 percent.

Comparisons of the distribution of accounts receivable loans, by class of bank, with the distribution characteristic of consumer instalment loans may be made from Table 6 and Table C–2.[11] It has been stated that the relative importance of receivables loans is greater for the relatively small than for

[10] For distributions of these data by size of center of population, deposit size of bank and region see Appendix Table C-1.

[11] Compare John M. Chapman and Associates, *op. cit.*, p. 36.

Table 6—AMOUNT OF ACCOUNTS RECEIVABLE LOANS AND TOTAL LOANS OF COMMERCIAL BANKS, AND ACCOUNTS RECEIVABLE LOANS IN PERCENT OF TOTAL LOANS, AS OF MID-1940, BY DEPOSIT SIZE OF REPORTING BANK [a]

Deposit Size of Bank [b]	*Number of Reporting Banks*	*Accounts Receivable Loan Balances Reported*		*Total Loans and Discounts of Reporting Banks*	ACCOUNTS RECEIVABLE BALANCES		
					Total		*In % of Total Loans and Discounts*
		Retail	Non-Retail		Amount	Percent	
$5,000 or less	30	$135,014	$857,200	$29,520,000	$992,214	6.0%	3.4%
5,000–10,000	13	113,569	889,874	33,295,000	1,003,443	6.1	3.0
10,000–50,000	26	409,327	7,619,997	188,682,000	8,029,324	48.7	4.3
Over 50,000	19	309,512	6,122,949	1,596,609,000	6,432,461	39.0	.4
TOTAL	88	$967,422	$15,490,020	$1,848,106,000	$16,457,442	100.0%	.9%

[a] Based on a questionnaire survey.
[b] Total deposits in thousands of dollars. Each size class is exclusive of the lower limit and inclusive of the upper.

the relatively large banks; Table C–2 shows that it is also greater for the banks in smaller centers of population than in the larger cities. It is important to note, however, that accounts receivable loans are not of great relative importance in any group of banks, whether the classification is by size of bank, size of city or region. This conclusion is in marked contrast to findings regarding personal loans. A 1939 study by the National Bureau of Economic Research showed that the ratio of personal loans to total loans and discounts varied from 42 percent for banks with total loans and investments of less than $150 thousand to 1 percent for banks of $50 million and over in total loans and investments.

While it is true that accounts receivable loans are relatively unimportant when compared to total loans and discounts and contrasted with similar measures of the importance of personal loans, it is necessary to note that receivables loans have a much more rapid turnover. It would take at least seven times as many personal loans of average maturity as accounts receivable loans to produce a given volume of business. This point must be borne in mind in considering the profitability of loans secured by assignments of receivables. The rapid turnover raises considerably the costs of operation per dollar of balances held but where charges are based on the volume of receivables purchased a rapid turnover also increases income.

4

Characteristics of Clients

FOR THE PURPOSES of the present study the most important characteristics of concerns using receivables financing are size, industrial type and credit standing. Adequate information on these three characteristics would make it possible to show the extent to which the different financing agencies serve the same types of customers and would also define the market areas in which the various agencies are most active. It is very difficult to assemble data on the clients of particular types of agencies and it has therefore been necessary to describe only the main outlines of the factoring and non-notification markets.

Clients of Factors

Very little information is available on the size characteristics of the individual clients of factoring companies. It is known, however, that textile manufacturers, converters and selling agents comprise the bulk of the concerns that utilize factoring services. Table 7 gives the size distribution of all corporations in the textile industry, indicating the outlines of the principal market for factoring services.

It will be seen in Table 7 that most of the concerns producing textile mill products are small but that the large companies make more than half of the sales. Of the 7,128 textile corporations submitting balance sheets with their 1937 Federal corporation income tax returns, 85 percent had assets of less than $500,000 but these accounted for only about 25 percent of the total sales. It may be that financial and other considerations make it more likely that the relatively small concerns will seek factoring services but there is only indirect statistical evidence to test this hypothesis. Furthermore, there

Table 7—TOTAL ASSETS AND GROSS SALES OF TEXTILE MANUFACTURERS, 1937, BY ASSET SIZE [a]
(*dollar figures in thousands*)

Asset Size [b]	*Number of Corporations*	*Total Assets*		*Gross Sales*		
		Amount	Percent	Amount	Percent	Average per Corp.
Under $50	3,177	$61,025	1.7%	$177,199	4.1%	$56
50–100	987	70,316	1.9	168,151	3.9	170
100–250	1,128	180,283	5.0	356,927	8.2	316
250–500	665	237,953	6.5	400,920	9.2	603
500–1,000	506	355,083	9.8	518,908	11.9	1,026
1,000–5,000	538	1,130,749	31.2	1,340,289	30.9	2,491
5,000–10,000	77	508,870	14.0	499,366	11.5	6,485
10,000 and over	50	1,083,827	29.9	881,839	20.3	17,637
TOTAL	7,128	$3,628,106	100.0%	$4,343,599	100.0%	$609

[a] Based on *Statistics of Income for 1937*, Part 2, pp. 101-02. Includes income and deficit corporations submitting balance sheets with 1937 corporate income tax returns.
[b] Each size class is inclusive of the lower limit and exclusive of the upper.

are indications that even the largest concerns use the services of the factor, if not for all of their sales at least for all sales of a specific division of their business. It seems to be generally agreed that most of the clients of factors range in total asset size from $100 thousand to $3 million and that the concerns at the upper end of this range account for most of the factoring volume. Certain clients of factors, among them some of the largest concerns in the textile industry, have total assets greatly in excess of $3 million. Likewise, there is a wide range in amounts of receivables originated by individual clients and held by the factor at any one time. These amounts range, for the bulk of clients, between $30,000 and $300,000, with most of the factoring business originating in the larger accounts.[1] A few clients would have much more than $300,000 of unmatured sales held by the factor at any one time.

Going beyond their traditional specialization in textile financing, factors have recently extended their services to other industries. The information available on the extent of this diversification and on the chief characteristics of the companies served is fragmentary and comes from statements made in advertising matter, financial reports and stock prospectuses. In these sources the following industries are mentioned as served by certain factoring companies: shoes, men's clothing, furniture, bottles, paper, radio tubes, rubber goods, carpets, gloves, home furnishings, petroleum products, glass, liquor, furs, lumber, coal, and metal products. Doubtless this list could be added to; it is generally estimated in the trade that at this time, in the early stages of non-textile factoring, these lines account for about 10 percent of factoring volume.

It should be emphasized that some companies have been more aggressive than others in going into non-textile factor-

[1] Clients are in most instances manufacturers, converters and selling agents and vary in number for different factors from 100 to 400. The six large factors purchased receivables in amounts varying from $31 million to nearly $122 million. These data have not been used to compute average size of clients because of the wide differences in size and because, in many cases, clients sell receivables to the factor while making little if any use of the factor's funds. Their need is apparently exclusively for the credit approving, collection and risk-taking services of the factor.

ing; some companies still restrict themselves exclusively to that field, and some, within textiles, to woolen and worsted trades. Also, the volume developed outside of textiles is sometimes accepted by factors on a recourse basis. In this respect it represents an operation closely akin to that of the non-notification commercial finance companies, but it differs in the important respect that the factors notify the trade customers and collect the accounts.

There is virtually no information available on the characteristics of the customers of the factor's clients, namely, those whose obligations are purchased when a factoring company buys receivables. But it seems reasonable to infer from the nature of the factor's clients—and this inference is verified by individuals in the trade—that these debtors are mainly in the cutting-up trade, manufacturing, jobbing and retailing. One factoring company reported that the $14.6 million of receivables on its books on September 30, 1936 represented debts of 17,000 customers spread throughout the country. This would make an average balance per client's customer (that is, trade debtor) of about $800; further information shows that during 1936 the factor purchased, on the average, about $5,000 of receivables for each of its client's customers.

Clients of Non-Notification Financing Agencies

The principal characteristics of concerns utilizing the receivables financing services of commercial banks and commercial finance companies can be described with considerable factual detail on the basis of information assembled from 24 banks and 2 commercial finance companies. These institutions were asked to supply certain information on each of their clients. Because of the similarity of the services offered by the banks and commercial finance companies, reports from both types of agencies are combined in the following tables. In Table 8, which distributes the reported loan balances according to the main business activity of the vendor or assignor of the receivable, it is shown that clients are predominantly from the manufacturing industries; this group comprised 220

Table 8—NUMBER AND AMOUNT OF ACCOUNTS RECEIVABLE LOAN BALANCES, BY MAIN BUSINESS ACTIVITY OF CLIENT [a]

Main Business Activity of Client [b]	*Number of Clients*	*Loan Balances Reported*	
		Amount	Percent
Mining and extraction	4	$51,016	.4%
Construction	11	348,616	2.6
Manufacturing	220	9,581,232	70.1
Food and kindred products	11	689,995	5.0
Textile mill products	20	1,235,881	9.0
Apparel and other finished fabric products	23	1,157,023	8.5
Furniture and finished lumber products	22	1,096,054	8.0
Paper and allied products	12	684,722	5.0
Printing, publishing and allied industries	11	155,580	1.1
Leather and leather products	10	345,264	2.5
Stone, clay and glass products	14	171,205	1.3
Iron and steel and products	31	599,924	4.4
Transportation equipment (excluding autos)	13	294,047	2.2
Machinery	25	791,982	5.8
Other manufacturing	28	2,359,555	17.3
Wholesaling	69	1,920,108	14.0
Food and kindred products	12	135,271	1.0
Textile mill products, apparel and other finished fabric products	6	359,869	2.6
Lumber and lumber basic products	7	432,199	3.2
Metals and their products	13	499,000	3.6
Machinery	10	175,000	1.3
Chemicals and allied products and products of petroleum, coal and natural gas	7	27,049	.2
Other wholesaling	14	291,720	2.1
Retail trade	24	1,524,150	11.2
Service	33	237,127	1.7
TOTAL	361	$13,662,249	100.0%

[a] Data supplied by 24 commercial banks and 2 commercial finance companies.
[b] Classified according to the Standard Industrial Classification.

of the 361 clients and 70 percent of all loan balances reported. Within the manufacturing group there is a very wide distribution of clients; the most important are manufacturers of textile mill products, apparel, and furniture and other finished lumber products. It is interesting that not one of the eleven specific groups of manufacturing industries accounted for as much as 10 percent of the loan balances reported. After manu-

Table 9—NUMBER AND AMOUNT OF ACCOUNTS RECEIVABLE LOAN BALANCES, BY AVERAGE LOAN BALANCE AND BY CLIENT'S TOTAL ASSETS [a] (*dollar figures in thousands*)

Average Loan Balance [b]	ASSET SIZE [b]															
	Under $50		*$50-200*		*$200-500*		*$500-1,000*		*$1,000-2,000*		*$2,000-3,000*		*$3,000 and Over*		*Total*	
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
Under $1	18	$10.3	3	$1.6	..	..	..	..	..	..	..	..	..	..	21	$11.9
1–2.5	29	45.4	17	29.1	..	..	1	$2.0	..	..	..	..	..	..	47	76.5
2.5–5	19	92.6	12	38.6	6	$21.2	..	..	..	..	..	..	..	..	47	152.4
5–10	26	175.9	28	200.1	3	21.1	2	17.9	..	..	..	..	..	..	59	415.0
10–25	6	74.9	33	521.8	13	228.3	9	135.6	1	$17.2	..	..	2	$31.5	64	1,009.3
25–50	2	71.5	13	428.4	19	625.2	7	263.7	3	95.0	..	..	..	..	44	1,483.8
50–100	..	..	6	364.5	20	1,245.5	11	750.5	5	362.5	1	$70.0	..	..	43	2,793.0
100–200	..	..	..	..	7	937.0	4	588.5	5	736.1	2	312.1	..	..	18	2,573.7
200–500	..	..	..	..	..	..	2	671.3	1	350.0	1	247.0	4	1,185.3	8	2,453.6
500 and over	..	..	..	..	..	..	..	..	..	..	1	640.0	2	1,950.0	3	2,590.0
TOTAL	110	$470.6	112	$1,584.1	68	$3,078.3	36	$2,429.5	15	$1,560.8	5	$1,269.1	8	$3,166.8	354	$13,559.2
Percent		3.5%		11.7%		22.7%		17.9%		11.5%		9.4%		23.4%		100.0%

[a] Data supplied by 24 commercial banks and 2 commercial finance companies.
[b] Each size class is inclusive of the lower limit and exclusive of the upper.

facturing, the next most important classes of clients are wholesalers and retailers, accounting for 14 percent and 11 percent, respectively, of reported balances. This table shows clearly that non-notification financing has a far greater industrial diversification than old-line factoring.

Table 9 shows the total assets of clients obtaining funds through the sale or assignment of accounts receivable to commercial finance companies and banks. It is obvious that this type of financing is used to a surprising extent by very small firms; 110 (about 31 percent) of the 354 clients classified had total assets of less than $50,000. However, these small concerns borrowed less than 4 percent of the total balances reported. Concerns with total assets of less than $200,000 accounted for 63 percent of the total clients and 15 percent of the loan balances reported. It is clear, therefore, that while the small firms constitute a majority of the borrowers, their balances are far less important than the balances of the less numerous larger clients.

In Table 10 additional data are presented covering the operations of one medium-sized regional commercial finance company. This table is of particular interest in that it shows the wide range in amounts of receivables held for different industrial types of trade debtors. These average amounts vary all the way from $19 for what are probably retailers of artificial flowers to $20,011 for the customers of construction and engineering concerns.

Two sets of facts permit a further description of the concerns borrowing on the non-notification assignment of their accounts receivable and reflect, indirectly, the financial strength of these concerns. In general, the evidence indicates, first, that these concerns do not continue to finance themselves on this basis for a long period of time with any particular financing agency and, second, that they infrequently borrow concurrently from a second institution. With regard to the first consideration the following data show that, for the sample of cases studied, the average period over which current receivables borrowers have been clients of a particular lender is only

Table 10—AVERAGE AMOUNT OF RECEIVABLES HELD BY ONE REGIONAL COMMERCIAL FINANCE COMPANY PER CLIENT AND PER TRADE DEBTOR, DECEMBER 31, 1940, BY INDUSTRY OF CLIENT

Industry of Client	*Average Amount of Receivables Held*	
	Per Client	Per Trade Debtor
Auto parts, accessories and equipment	$11,054	$232
Brushes	4,159	154
Building materials	13,264	276
Cellulose products	1,136	76
Chemical compounds and fluids	2,516	387
Clothing (men's)	15,422	313
Clothing (women's)	4,953	127
Coal	11,459	164
Construction and engineering	40,021	20,011
Electrical appliances and equipment	19,580	113
Flowers (artificial)	535	19
Foodstuffs	10,628	140
Furniture (wholesale)	17,440	764
Glassware	23,528	392
Hardware	15,608	202
Household goods and equipment	6,389	55
Household utensils	39,101	99
Industrial equipment and supplies	5,137	266
Jewelry	4,080	102
Leather and hides	22,290	2,123
Lumber and plywood	28,671	746
Medical supplies and drugs	5,572	138
Metal novelties and specialties	3,509	44
Miscellaneous	4,828	3,863
Notions and beauty supplies	37,549	333
Oil (fuel)	5,592	205
Optical supplies	16,471	289
Paint and varnish	11,266	99
Plumbing and heating supplies	13,691	522
Printing, lithography, binding	7,551	145
Radios	22,000	324
Rags and waste	9,191	1,451
Ribbons	7,821	42
Rubber goods and novelties	18,461	471
Steel and metals	50,920	828
Tobacco	895	179
Tools and dies	261	261
Toys and play equipment	3,783	52
Twine and cordage	12,905	215
Wines and liquors	10,558	175
Yarn and cloth	3,328	1,331

about two years. This average is based on reports from non-notification agencies classifying their present clients according to the year in which their first receivables loan was granted.

Year of First Receivables Loan	*Number of Present Clients*
1941	98
1940	119
1939	89
1938	54
1937	25
1936	14
1935	18
1934	5
1933	3
1932	2
1930	1
1927	1
Number reported	429
No information	8
TOTAL	437

Average number of years present clients have been receiving loans from reporting agencies: 2.07 [a]

---

[a] Average computed by assuming that clients reported as receiving first receivables loan in 1941 were served one-half year by the time the survey was made, that those reported for 1940 had been served for one year, 1939 concerns for two years, etc. Based on data supplied by 24 commercial banks and 2 commercial finance companies.

These data do not bear directly on the question of how long, on the average, receivables financing is used by borrowers since they relate only to present borrowing clients. Since these clients will continue to use the financing agency's services for some additional period the data do not indicate the whole span of the client's patronage of a given agency. The findings correspond roughly, however, to impressions and definite statements obtained in the field; the actual span of use is generally stated at about 3½ to 4 years, although some agencies claim that customers may use their facilities for 5 or 6 years, or even longer. One agency reported that its customers either improved in a short time to the point where they could obtain the needed funds on other bases, enjoying more favorable rates because of a better credit standing, or tended to deteriorate to the extent that they could not obtain credit at all. It was stated that this would generally be true of the business as a whole, with the qualification that in old-line factoring the client's patronage continues over a much longer period.

Finally, some banks have maintained that receivables financing is properly considered as an "interim" form of obtaining funds. By this method, companies that would otherwise be inadequately financed, or totally without borrowed capital, are able to obtain funds. But if the company does not show signs of improvement in its financial position, the lender will break relations with the borrower.

Non-notification financing appears in many cases to be an exclusive method of short-term financing. Out of 358 receivables borrowers on which information was available, 173 used this as their only source of borrowed funds. Of the other concerns, some received additional funds from their receivables financing agency on some other basis than on the assignment of receivables, some acquired these additional funds from another agency, or, more rarely, from both the reporting agency and another lender. Because of the technical difficulties and added credit risk involved in taking assignments of receivables from a concern which also assigns part of its receivables to another agency, the lender almost never makes loans on this basis.

These two sets of facts constitute only indirect evidence and are by no means conclusive as regards the financial position of borrowers utilizing non-notification financing arrangements. However, in showing that these borrowers are very likely to be dependent upon receivables financing as the only source of funds and that the borrowers do not continue to use this source for long periods of time, the evidence suggests that the clients are, in many instances, in impaired financial position. This generalization was confirmed by numerous discussions with credit officers having experience in this field. It may be said, therefore, that the non-notification accounts receivable financing technique is used mainly by relatively small concerns of limited financial strength with the qualification that there are some concerns that use the service not because of an inability to obtain credit otherwise but because the receivables loans and the ancillary services provided by the re-

ceivables financing agency are deemed unique and desirable in themselves.

The borrowers reported in this survey were analyzed also with respect to their net worth, in an effort to throw some further light on the relative financial strength of non-notification borrowers. The results of this analysis show, first, that the size of the borrower's loan balance is closely related to the absolute amount of the company's net worth, increasing with increases in the amount of net worth. This relation is almost exactly the same as that displayed in Table 9 on asset size of borrower and amount of loan balance. Analysis of the ratios of net worth to total assets presented in Table 11 shows that there is a wide disparity among borrowers. Of the $13.5 million in receivables loan balances reported, approximately 1 percent had been lent to companies with a net worth deficit, 9 percent to concerns with net worth of less than 20 percent of total assets and about 12 percent to companies with net worth of 80 percent or more of total assets. In view of the fact that the ratio of net worth to total assets of all corporations in the United States reporting net income for tax returns in 1937 was nearly 60 percent and that this was true also of all corporations with total assets of less than $500,000, we

Table 11—Accounts Receivable Loan Balances, Classified by Ratio of Borrower's Net Worth to Total Assets [a] (*dollar figures in thousands*)

Ratio of Net Worth to Total Assets [b]	*Number of Companies*	*Loan Balances Reported*	
		Amount	Percent
Under 20%	27	$1,273.3	9.4%
20–40	89	4,292.2	31.9
40–60	115	3,294.7	24.5
60–80	86	2,886.8	21.4
80 and over	27	1,607.5	11.9
Deficit	6	123.4	.9
Total	350	$13,477.9	100.0%

[a] Data supplied by 24 commercial banks and 2 commercial finance companies.
[b] Each class is inclusive of the lower limit and exclusive of the upper.

may infer from Table 11 that the average ratio of owner's equity to total assets for receivables borrowers was considerably less than for all companies. While this is not conclusive evidence that the group of receivables borrowers is relatively weak financially, it tends to support that view.

5

Credits and Associated Services

IT IS IMPORTANT TO ANY DESCRIPTION of accounts receivable financing to emphasize that the client, in many instances, seeks and obtains more than funds from the financing agency. The supplying of funds, *per se,* is frequently but one element in a combination of desired services. In this section, therefore, we shall deal, first, with the chief characteristics of the credit obtained and, second, with the associated services that are frequently extended to the client.

Size of Credits Extended

Factoring

While it is customary to describe borrowing arrangements in terms of the size of the loan extended and of other characteristics of loans, there are two senses in which it is misleading to think of factored accounts receivable in these terms. First, in the strict sense, the factoring transaction does not involve a *loan* at all; rather, the factor *purchases* those of the clients' receivables that conform to his established credit standards and assumes all credit risks involved in them. Second, this process of "cashing receivables" is a continuing relationship lasting for what may be a considerable period of time. The purchase of each individual receivable is, in a certain sense, a separate transaction, but in another sense it is part of a larger arrangement or relationship which involves the purchase of a great many receivables and which cannot be evaluated from a credit point of view without taking account of the continuing flow of *all* the receivables being purchased. The arrangement is a kind of revolving credit under which the client is supplied with funds in an amount determined by the rate at which

receivables are generated. We have, then, not a loan but an outstanding balance representing the amount of a client's receivables held by the factor at a given time. While the purchase of the receivables by the factor makes the factor's funds available immediately to the client, funds may be left with the factor, that is, the client may accumulate a credit balance. The factor, therefore, has an amount of funds in the client's business equal to the net amount [1] of the client's outstanding receivables minus the client's credit balance. It will not distort the facts to refer to this remainder as the client's outstanding *loan* balance, although it is understood that it is not really a loan to the client and does not appear on the latter's financial statement as a liability. The client is not responsible for paying this balance, except where receivables are purchased under a recourse agreement, but must make good for such merchandise claims and returns as arise.

Direct factual evidence concerning the size of these amounts, that is, the balances of client's unmatured sales held by the factor, is unavailable. As indicated above, most of these balances range from $30,000 to $300,000 with the great part of the factoring volume accounted for by the cases found at the upper limit of this range. However, no information is available on the credit balances that must be deducted from these to arrive at an estimate of the factor's net investment in the client's business. It is known that some clients are virtually non-borrowing, that is, their credit balances equal the amount of their unmatured sales. Others hold only the minimum amount agreed upon with the factor, say 5 or 10 percent of unmatured sales. The distribution is determined mainly by the client's need for funds and the terms upon which balances will be kept by the factor.

Another measure of the amount of the factor's business with an individual client is given by the volume of receivables purchased annually from individual clients. This may be inferred directly from the information already presented on outstanding balances of unmatured sales since it is not affected

[1] Net of reserves for discount.

by any credit balance that may be held by the client with the factor. On the assumption that receivables turn over 7 times a year, the range of amounts purchased would run from $210 thousand to $2.1 million. It should be indicated that a few accounts originate a volume considerably in excess of $2 million. One factoring company, for which information covers operations in recent years, reported that in 1940 it had purchased approximately $45 million in receivables, that no one client had provided more than 10 percent of this volume and, further, that the largest amount ever purchased from one client was $3 million in 1939.

When advances are made by the factor on a client's merchandise a loan transaction of conventional form has been entered into. Since not all of the factor's clients borrow on this basis, it is particularly misleading to compute *average* merchandise loan balances. It is known, however, that in 1940 one factor with about 300 clients had nearly $3.6 million in merchandise advances outstanding at year end and that another company with about 450 clients had only about $650,000 outstanding. Clearly, differences in management policy, as well as in the needs of clients, account for these widely different results.

Non-Notification Financing

Information on the size characteristics of the receivables balances owed by concerns using the facilities of non-notification financing agencies is summarized in Table 12 which gives the annual average loan balances of 361 clients classified according to the industry of the borrower.

These data show that the average of the balances of all non-notification clients was about $38,000 from which it would appear that non-notification balances are smaller, on the average, than factoring balances. Since the ratio of volume of receivables purchased to outstanding balances is about the same for these agencies as for factors it can be stated, further, that the volume of receivables purchased or assigned annually would also be smaller than the comparable measure of activity

Table 12—ACCOUNTS RECEIVABLE CLIENTS, 1940-41, BY AVERAGE LOAN BALANCE AND BY MAIN BUSINESS ACTIVITY [a] (*dollar figures in thousands*)

Average Loan Balance [b]	*Mining and Extraction*		*Construction*		*Manufacturing*		*Wholesaling*		*Retail Trade*		*Service*		*Total*		
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	Percent
Under $1	..	..	1	$.5	8	$3.8	3	$1.9	4	$1.6	10	$5.9	26	$13.7	.1%
1–2.5	1	$2.3	2	3.1	29	48.6	10	16.2	2	2.1	4	5.4	48	77.7	.6
2.5–5	..	..	2	9.0	26	82.8	10	31.9	3	8.0	6	20.7	47	152.4	1.1
5–10	..	..	1	6.0	32	240.0	13	82.3	6	40.5	7	46.1	59	414.9	3.0
10–25	3	48.7	2	37.0	41	661.1	12	169.5	3	47.0	3	46.0	64	1,009.3	7.4
25–50	..	..	..	..	33	1,079.4	8	311.5	1	40.0	2	53.0	44	1,483.9	10.9
50–100	..	..	2	120.0	29	1,882.5	9	580.5	2	150.0	1	60.0	43	2,793.0	20.4
100–200	..	..	1	173.0	13	1,730.7	3	485.0	2	285.0	..	..	19	2,673.7	19.6
200–500	..	..	..	..	7	2,212.3	1	241.3	..	..	..	..	8	2,453.6	18.0
500 and over	..	..	..	..	2	1,640.0	..	..	1	950.0	..	..	3	2,590.0	18.9
TOTAL	4	$51.0	11	$348.6	220	$9,581.2	69	$1,920.1	24	$1,524.2	33	$237.1	361	$13,662.2	
Percent of total amount		.4%		2.6%		70.0%		14.1%		11.2%		1.7%			100.0%
Average balance	$12.8		$31.7		$43.6		$27.8		$63.5		$7.2		$37.8		

[a] Based on data submitted by 24 commercial banks and 2 commercial finance companies.
[b] Each size class is inclusive of the lower limit and exclusive of the upper.

for factors. Additional information on average balances of the clients of one regional commercial finance company, classified by industry, was given in Table 10.

In a preceding chapter, Table 9 showed that there is a direct relationship between the size of the borrower and the size of loan balance. Since non-notification accounts receivable financing is used most frequently by small concerns, it is not surprising that many of the average balances of receivables clients are small in amount. This is borne out by Table 12 which shows that approximately one-half of a sample of borrowers had balances, in mid-1941, of less than $10,000, although these borrowers accounted for only 5 percent of all balances reported. Whatever determines the average size of the non-notification loan balance, the fact that it is most frequently relatively small in amount has an obvious bearing on the cost of extending such credits, on the profitability of the business, and also on the costs to the borrower.

In an attempt to determine whether a definite relation exists between the size of non-notification loan balances and the financial strength of concerns borrowing on this basis, a comparison was made between borrower loan balances and individual ratios of the borrower's net worth to total assets. The latter was taken as the only available measure of financial strength. These data are not presented here, but they indicate that average size of loan varied from $60,000 for concerns whose net worth equaled 80 percent or more of total assets to $21,000 for corporations having a net worth deficit. However, there were no substantial differences in the average loan balances of the groups of non-deficit companies of differing ratios of net worth to total assets. This may indicate an inadequacy in the sample of companies studied. More likely it indicates that the ratio of net worth to debt reflects neither the borrower's financial strength, *as viewed by a receivables lending agency,* nor the borrower's need for financing. With regard to the former, it is clear that, barring default by the client's trade debtors, the amount of the client's debt and its relation to total assets are of secondary importance since the

loan is collateralized by receivables upon which the lender has a prior lien. It would appear, therefore, that the principal elements affecting the size of balance extended are the size of the borrowing concern, its need for funds and its ability to generate acceptable receivables.

Information was not assembled directly on the average annual volume of receivables purchased or taken on assignment by commercial finance companies and banks from individual clients. An estimate of this amount may be made, however, from information on average balances and the lender's estimate of the turnover of the balance. Using a turnover figure of seven times a year we can say that approximately 50 percent of the clients covered in the survey generated an annual volume of receivables of less than $70,000 each, although the receivables purchased from these clients represented only 5 percent of the total volume purchased. Again, it will be recalled that in many ways the volume of receivables financed per client is more important to the understanding of receivables financing than is the size of the client's loan balance. The charge for the service rendered is frequently based on the volume of accounts assigned as well as on outstanding balances; the costs to the lender of handling an accounts receivable balance are primarily determined by volume.

Differences in the average loan balances of non-notification borrowers of different industrial types were shown in Table 12. Further evidence on this point with special reference to the receivables borrowers of commercial banks was revealed also in a questionnaire survey, some of the results of which are presented in Table 13. Commercial banks were asked to classify their total open accounts receivable loans outstanding at the time of the survey (July and August 1941), according to whether they were acquired from retail or non-retail concerns, and to give the approximate number of their clients.

Table 13 shows that the retail accounts were smaller than the other, mainly manufacturing, accounts; the former averaged about $8,000 and the latter about $20,000. It also shows that the size of the average receivables loan balance is greater

Table 13—AVERAGE ACCOUNTS RECEIVABLE LOAN BALANCES OF RETAIL AND OTHER CLIENTS, JUNE 1941 BY DEPOSIT SIZE OF BANK, SIZE OF POPULATION CENTER AND REGION IN WHICH BANK IS LOCATED [a]

	Retail		*Other than Retail*	
	Number	Average Amount	Number	Average Amount
Deposit Size of Bank [b]				
$5,000 or less	38	$3,553	152	$5,639
5,000–10,000	13	8,736	82	10,852
10,000–50,000	57	7,181	354	21,525
Over 50,000	13	23,809	186	32,919
ALL BANKS	121	7,995	774	20,036
Size of Center of Population [c]				
Under 10,000	16	2,903	21	2,800
10,000–50,000	11	5,714	32	10,637
50,000–100,000	12	2,305	85	9,788
100,000–500,000	45	12,363	240	16,162
500,000 and over	41	7,164	409	25,935
ALL BANKS	125	7,896	787	19,771
Region				
New England	20	2,604	196	20,659
Middle Atlantic	26	17,670	216	29,258
East North Central	45	3,556	163	13,188
West North Central	11	18,712	34	12,269
South Atlantic	..	..	28	10,478
East South Central	..	..	74	11,227
West South Central	13	4,081	26	20,269
Mountain	2	4,000	..	..
Pacific	8	6,073	50	22,208
ALL BANKS	125	$7,896	787	$19,771

[a] Based on a questionnaire survey.

[b] Total deposits in thousands of dollars. Each size class is exclusive of the lower limit and inclusive of the upper.

[c] Each size class is inclusive of the lower limit and exclusive of the upper.

in the larger banks and in banks located in the larger centers of population than in the smaller banks and those located in smaller places. Perhaps the most important fact brought out in this table is the very small average size of loan balances in the smaller banks (with deposits of under $5 million) and in banks in smaller centers (of less than 100,000 population). In most instances the average balance reported for banks in these groups was less than the $10,000 minimum balance considered necessary by experienced commercial finance companies

for profitable operation and far below the $25,000 balance considered by some as the minimum.

It will be noted that the average balance shown in the earlier table ($38,000), based on special reports from selected banks, is larger than the average balance shown in Table 13. This reveals a degree of non-representativeness in the reports from the selected banks, not unexpected in view of the fact that the banks submitting special schedules of information on their receivables loans were banks that had made a special effort to develop this line of financing.

Average Size of Client's Receivables

Factoring

In many respects the individual invoice is a more important item in the factoring process than is the total amount of the client's unmatured sales held by the factor. Since all the credit risks are assumed on sales cashed, the factor must approve each sale *before* it is made. Once a sale has been approved and the invoice purchased, the factor merges this account with the total of purchased sales outstanding; the only sense in which the client is further involved is that some adjustments may be required on account of merchandise returns or other offsets. The principal ledger of the factor is set up alphabetically by the customers whose payables are owned by the factor. Each customer has a separate ledger card and entries are made on this card as sales to the customer are approved or remittances received. The ledger card of a given trade customer may show sales to this customer by a number of the factor's clients; on the other hand, the customer may buy from only one of the factor's clients. It will be seen, therefore, that the factor's credit appraisal activity revolves about the individual sale and invoice. Unfortunately, there is no body of statistical information available as to the size of these individual sales. They may vary all the way from sales of a few dollars' worth of merchandise to sales by manufacturers to other manufacturers or large retail outlets, amounting to several thousands of dollars. The average size depends on the nature of the sales market and the kind of goods sold.

Non-Notification Financing

In non-notification financing, as in old-line factoring, individual accounts receivable assigned as security for a loan or purchased by the financing agency are of primary importance for the reason that the average size of the transaction has an important bearing on the cost of administering receivables credits and, even though taken with recourse on the vendor of the account, considerable effect on the risk involved in any given credit extension. Information was sought on the average size of the receivables financed, but a special problem complicates the interpretation of the reports. This problem arises out of the fact that although factors buy individual invoices, commercial banks *sometimes* take an assignment of the whole account owed by the client's trade debtor (even though this account represents a cumulation of a number of separate invoices bearing different dates) or they may take an assignment of *all* the client's outstanding receivables. For this reason, some banks did not know the average amount of the invoices originated by their clients.

The results of this survey of non-notification financing, as summarized below, reveal that clients whose average invoices were less than $250 had 47 percent of the total loan balances reported while clients with average invoices of under $100 had over 25 percent. A sizable proportion of the loan balances, 26 percent, represented clients whose invoices averaged $5,000 and over. Accounts receivable loan balances of 316 clients are classified, according to the average size of the receivables that secure them, as follows:

Average Amount of Clients' Invoices	*Number of Clients*	*Loan Balances Reported*	
		Amount (000)	Percent
Under $100	65	$2,826.7	27.3%
100–250	61	2,041.1	19.7
250–500	49	1,178.8	11.4
500–1,000	32	779.2	7.5
1,000–5,000	58	828.5	8.0
5,000 and over	51	2,698.5	26.1
TOTAL	316	$10,352.8	100.0%

Whether these averages refer to single invoices or groups of invoices is unimportant; what matters is that the unit transactions involve very small dollar amounts. It follows from this that the cost of administering receivables credit, per dollar of funds advanced, is high as contrasted with conventional commercial lending.[2]

The information on average size of client's invoice makes it possible to estimate, very roughly, the magnitude of the detail involved in many accounts receivable loans. We know that the average loan balance reported in the special schedules prepared for the National Bureau by financing agencies was about $38,000 (Table 12) and that an average balance of this amount would represent about $250,000 in receivables purchased over a year. Thus, if this average loan balance can be applied to the 40 percent of the clients and the 47 percent of the loan balances reported as having average invoices of less than $250, we may conclude that the financing agency is required to handle, on the average, 1,000 or more separate invoices or accounts per year for such clients. For clients with invoices of $100, an average loan balance of this size would involve the handling of 2,500 separate accounts or invoices. It is this requirement that has given considerable stimulus to the development, among commercial banks, of operating plans that reduce to a minimum the handling of individual invoices.

Term and Repayment Provisions of Credits

Factoring

In old-line factoring the contract between client and factor, under which the factoring process is carried on, may stipulate no contract period at all or may set a definite period of one year or more during which it is to remain in force. If no period is stipulated the contract is usually prepared so that it can be terminated on 90-day notice by either party; otherwise the contract generally provides that the arrangement can be

[2] This point cannot be fully demonstrated except by a careful statement of the steps taken in handling each individual invoice. Such a statement is given in Chapter 6, where the conventional methods are described along with other operating plans that attempt to minimize the handling costs of receivables loan balances.

terminated at the end of any given contract period, on 60-day notice by either party. This is the only sense in which it can be said that the factoring arrangement has a "term" or contractual period. No information is available on the actual length of time over which a financing arrangement is continued between the client and any particular factoring company although it is frequently stated that these relations continue over a long period of time.

Some information is available, however, on the rate of turnover of receivables sold to factoring companies. This is indicated by what is called the collection period and is expressed in days; it can be estimated by dividing the volume of receivables purchased annually by the average amount of outstanding receivables held by the factor through the year and by then dividing the result into 365, or, more easily, by dividing the annual average of receivables held by the daily volume of receivables acquired. The data available on this point, which are not presented here in tabular form, cover a varying number of companies over the 24-year period, 1917-40. These data show that since 1929 the collection period has not averaged more than 55 days in any year and has been as low as 39. For 1940 the average collection period was 51 days; that is, receivables turned over, on the average, seven times a year, although one large company stated in an interview that its average collection period during 1941 was about 35 days.

If a tendency for the collection period to increase reflects a deterioration in the account it may be necessary to take certain protective measures but these vary, depending upon whether the arrangement is of the factoring type or is non-notification financing with recourse on the client. In factoring, a severe deterioration in a special group of accounts can be dealt with by refusing to buy such accounts. A less serious situation might be adjusted by a higher factoring charge which would enable the factor to accumulate a larger reserve to absorb losses that might accrue on the account. Other situations such as greater than usual returns of merchandise can be taken care of by requiring that the client hold a larger percentage

of unmatured sales in a credit balance with the factor but this can provide no protection for the credit risk since this is definitely assumed by the factor when the account is purchased.

Non-Notification Financing

In non-notification financing, as in factoring, the period of time over which the relation between financing agency and client continues is the only significant measure of the term of the loan. As was stated above, information on the length of this period was available only for clients that were still being financed by the reporting agencies; for these clients the period averaged about two years. There is a tendency for non-notification financing to be carried on under term contracts, as in factoring, although this has no necessary relation to the period of time that a client will use the financing services of a given agency. Such contracts are usually of one-year term; other contracts do not specify a definite period over which they are to remain in force and are terminable by either party on 30-day notice.

Information on the average period or turnover of client's receivables was assembled in special reports from 24 commercial banks and 2 commercial finance companies. These data are summarized below.

Average Turnover of Clients' Receivables	*Loan Balances Reported*		
	Number	Amount (000)	Percent
Under 30 days	55	$1,348.9	10.3%
30–44 days	98	4,246.1	32.3
45–59 days	83	3,274.5	24.9
60 days and over	108	4,287.0	32.5
TOTAL	344	$13,156.5	100.0%

These data are estimates, made by the reporting lending agencies, of the average turnover period of the receivables of each of their clients as of the middle of 1941.[3] They indicate

[3] A large number of balances were reported as turning over in exactly 60 days; only a few exceeded 75. Agencies were advised specifically to limit their reports to *open* accounts receivable loans. If loans secured by instalment receivables had been included, the average period would, of course, have been much longer.

that non-notification receivables turn over at about the same rate as the receivables purchased by factoring companies, a statement that is borne out by the fact that the collection period of combined open account and factoring receivables of Commercial Credit Company varied between 44 and 55 days over the period 1936-40, inclusive.[4]

While the actual turnover of accounts receivable is determined for commercial banks by the same considerations that affect the liquidity of these assets when acquired by other agencies, the problem for banks is somewhat different since they usually take the receivables as collateral for a loan rather than purchase them. The bank formulates the collateral loan so that it has a specified maturity date or it makes the loan on a demand basis, the customer being required, usually, to sign an ordinary collateral note at the time of each assignment. Many banks were found to use the demand note basis but most banks interviewed set up a definite maturity to conform, as far as possible, to the expected collection period of the receivables which secure the loan. While the notes generally have terms not longer than 60 days, this maturity can be extended if circumstances warrant.

The fact that the borrower often signs a new note with each assignment of receivables means that a given borrower may have several notes of different original and maturity dates outstanding at the same time. In this case the bank may attempt to match the collection on a particular account with the note arising out of its assignment, a difficult and perhaps impossible task except when individual accounts are unusually large. More frequently, the bank applies all collections as received to the *oldest* note outstanding. Some institutions simplify the procedure by allowing only one assignment and one note to be extant at a time. That is, a given note must be wholly paid out from the remittances on the accounts that secure it before a new note is drawn up. This has the advantage of simplicity but the possible objection of not providing continuous financing of

[4] Based on data in the *29 Annual Report* of Commercial Credit Company for the year ending December 31, 1940, p. 15.

accounts as generated. Another technique of commercial bank operation is to require a new note, covering new advances *and* the unpaid balances of previous advances, when each assignment of accounts is taken. This has the advantages both of simplicity and continuous financing but it is avoided by some banks because, in some states, to take an assignment of accounts for a *previous* debt would invalidate the assignment.

Just as in factoring, any notable increase in the average period of time for which its receivables are outstanding is watched with great care by the non-notification agency and certain measures may be taken to provide necessary additional protection. These may be in the form of increased service charges to the client (providing for larger reserves), or a refusal to take certain accounts that are longer than usual. More likely, the protection will be sought by a reduction in the percentage that the financing agency advances on any given group of receivables. It will also be clear that a shortening of the average collection period tends to increase the costs of operation per dollar of average outstandings. This can be compensated for by a charge levied on volume rather than on outstandings or by some combination of the two types of charges.

Before concluding this section on maturity provisions in accounts receivable financing, one additional point should be made with respect to the repayment plan for such loans. Clearly, a given lot of receivables, taken as collateral for a bank loan, provides the *means* of repayment, as individual accounts are collected. In general, therefore, if collections are applied directly to the note the rate of repayment is determined by collection experience. But some banks do not reduce notes directly as collections are made. Rather, collections are paid into a cash collateral account and sums are drawn from this periodically for application to the loan, the remainder, which represents the client's equity in the collections, being paid to the client. This has the effect of increasing the dollar cost of the service to the borrower if the cost is computed as a certain percent of the outstanding loan balance. On the other

hand, it has the advantage of simplifying the task of applying collections to outstanding loan balances.[5]

The technique of repayment used by commercial finance companies is somewhat different. Since this type of company usually operates under a purchase and sale agreement, there is no problem of one or a series of notes. A schedule of accounts is purchased at, say, 80 percent of the face amount of the accounts and as collections are made the finance company retains 80 percent of the receipts plus an amount equal to allowances for returns, etc., and less any credits for overpayments and the like. In this way there is a continuing sale of accounts and regaining of equity in collections as received. This is also the procedure followed by factoring companies.

Finally, it should be pointed out that both banks and commercial finance companies may have their notes paid or receivables liquidated by requiring the borrower, under their recourse arrangement, to repurchase them, or "take them up" at their maturity date. Generally speaking, 30 or 60 days after due date is the maximum delinquency allowance that lenders permit although certain exceptions may be made. The bank may require the borrower to take up the delinquent accounts by cash payment or exercise the right to charge these against the borrower's commercial deposit account. Since the finance company does not hold deposit balances for its clients, it can deduct delinquent accounts only from the customer's equity in collections. Such arrangements set real limits on the period a given receivable can be outstanding, although they do not affect the period of the "financing" arrangement between borrower and lender unless delinquency becomes serious.[6]

[5] The strategic legal condition of preventing the borrower from obtaining dominion over collections is accomplished by the establishment of a cash collateral account, but this legal protection is not affected by the frequency with which funds are applied to the note.

[6] Again, the procedure usually followed by banks of requiring that delinquent notes be taken up by a cash payment and their unwillingness to accept a substitution of new for old accounts is determined by legal conditions. Substitution might establish a preference on the ground that the assignment is for an antecedent debt.

Percentage Advance on Accounts Receivable

In receivables financing the percentage advanced on accounts receivable purchased, or taken on assignment, by the financing agency is, perhaps, the most important single risk-limiting device. It is necessary, however, to distinguish between the use of this device in factoring as contrasted with non-notification financing.

Factoring

The arrangement between factor and client usually provides that a certain amount of the proceeds arising from the purchase of a given amount of receivables will be left with the factor by the client as a "credit balance." The purpose of this balance is to provide a fund out of which provision can be made for any adjustments resulting from returns of merchandise, allowances or other offsets that are claimed by and granted to the client's trade customers. There seems to be no general rule regarding the amount of the credit balance that must be held but it is stated that 5 percent of unmatured sales is the usual requirement. This is smaller than in non-notification financing, because the client's balance does not have to absorb credit losses; these losses must be charged to the factor's own loss reserves. Actually, the credit balance of the client may be much greater than this minimum requirement since the client's need for funds may be much less than the need for credit approval and collection services and thus considerable balances may be accumulated. As a rule the balances carry interest for the client at 6 percent per annum, but where they assume much larger than necessary proportions the rate may be revised downward. In some cases the balances carry no interest return for the client. Clearly, while these funds are available to the factor, they are held as a demand liability and, except for very small factoring companies, would be expensive funds at 6 percent per annum. While there is no formal arrangement stipulating the percentage of cash proceeds to be left with the factor, that is, the amount of the credit balance to be maintained, the factoring company keeps a close watch

over the amount of the balance and if it seems insufficient the client is asked to leave a larger amount.

Non-Notification Financing

Since the non-notification financing agency does not assume the credit risk on purchased receivables, or on those taken as collateral, it is necessary to maintain a continuing margin over the amount advanced or loaned to the client. This balance must be large enough to absorb not only the returns and allowances for which the factor seeks protection but also the outright losses sustained on receivables held. Further, it is generally set so as to advance no more than the client's costs of goods sold. Some evidence as to the percentage advances made by non-notification agencies was assembled by the National Bureau in a mid-1941 survey and is given in Table 14. This shows that the advance is seldom under 70 percent of the face value of the receivables. Only 42 out of 357 clients received less than 70 percent of the face value of their receivables as an advance of funds. Furthermore, balances involving this relatively low percentage advance were, on the whole, smaller than those on which larger percentages of the face value of receivables had been advanced. From 70 to 90 percent is the range within which the percentage advance is most likely to fall.

This variation in the percentage advanced shows that lending agencies adjust the percentage, over fairly wide ranges, according to what they believe to be the degree of risk in any given client's receivables. Of course, the percentage advance is likely to become the focus of competition among lenders and may be in part a reflection of this condition as well as of the lender's judgment of the most appropriate margin of safety on the account. Nonetheless, competitive conditions cannot increase the percentage advance, or alter any other aspect of the credit bargain to the advantage of the borrower, without affecting the margin of safety that the lending agency maintains for its protection. In determining this margin the lender has to take account of a number of elements:

Table 14—ACCOUNTS RECEIVABLE LOAN BALANCES, 1940-41, BY PERCENTAGE ADVANCED AND BY SIZE OF ANNUAL AVERAGE LOAN BALANCE [a] (*dollar figures in thousands*)

Percentage Advanced	ANNUAL AVERAGE LOAN BALANCE [b]												
	Under $2.5		*$2.5–10*		*$10–50*		*$50–200*		*$200 and Over*		*Total*		
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	Percent
Under 50%	7	$4.6	1	$8.0	..	..	..	..	..	..	8	$12.6	.1%
50–59	5	6.5	5	28.1	3	$48.9	1	$95.0	..	..	14	178.5	1.3
60–69	6	5.1	8	51.4	3	84.4	3	293.0	..	..	20	433.9	3.3
70–79	31	41.8	44	227.4	31	677.7	17	1,410.9	2	$1,241.3	125	3,599.1	27.0
80–89	21	28.7	41	223.6	55	1,284.5	18	1,572.2	5	1,527.4	140	4,636.4	34.7
90 and over	4	4.9	7	28.9	16	397.6	19	1,779.1	4	2,275.0	50	4,485.5	33.6
TOTAL	74	$91.6	106	$567.4	108	$2,493.1	58	$5,150.2	11	$5,043.7	357	$13,346.0	
Percent of loan balance	.7%		4.3%		18.7%		38.6%		37.7%				100.0%

[a] Data supplied by 24 commercial banks and 2 commercial finance companies.
[b] Each size class is inclusive of the lower limit, and exclusive of the upper.

(a) the general financial responsibility of the borrower and the moral hazard involved
(b) the client's line of business and the kind and quality of customers served
(c) the size of the accounts purchased or taken as security
(d) the expected ratio of returned merchandise to total sales
(e) the cash discounts that will be taken by the trade debtor
(f) the expected ratio of losses on bad debts to total receivables acquired
(g) the difference between the sales price of the goods sold and their cost of production.

The ratio of bad debt losses to total receivables includes clear charge-offs as well as the accounts that may become delinquent and so have to be charged back to the client. Beyond the ratios given in (d), (e), (f) and (g), all of which can be determined by studies of past experience, the lender maintains an additional margin to take account of undeterminable risks and to shorten the period during which collections on a given batch of receivables should equal the amount advanced on them or should pay out the loan balance which they secure.

It might be added that in non-notification financing, the withholding of a certain portion of the borrower's equity until the account has been paid has the special advantage of encouraging prompt collection by the borrower. Assuming a 70 percent advance, then, for every dollar collected the borrower can claim a 30 cent equity. By increasing the amount of the client's equity the lender limits his risk both by having a larger margin of safety and by giving the borrower a greater stimulus to press collection efforts.

Services Associated with Receivables Financing

Factoring

The most important services of the old-line factor are credit checking, absorption of credit losses on approved accounts

and collection of accounts. It is clear that if the factoring company is to assume the credit losses on purchased receivables, it must have absolute control over the extension and collection of the credits. Thus each factor maintains a credit department to approve or disapprove credit sales by clients and to supervise collections. In some instances this means that the mill dispenses with credit and associated departments, including accounts receivable bookkeeping, passing these functions, with the expense of performing them, over to the factor and paying in return a factoring commission.

In addition to these services, the old-line factor did in the past perform some selling or merchandising functions for the textile mill client. In general, these were of three, necessarily related, kinds: providing advice on the styling of merchandise and other marketing problems; selling the mill's output on a commission or other basis; providing the client with space on the factor's premises for use as display quarters. While the factoring companies have tended to drop the selling function, they may still offer guidance on such matters as the selection of a selling agent or other related problems. Because of the long experience of the factor's personnel in the textile industry, they are in a peculiarly advantageous position to offer this service to textile clients. Furthermore, the factor's interest is best served, as is the client's, by promoting the mill's sales; the factor has good reason to stimulate the client's sales along profitable lines.

Non-Notification Financing

Where accounts receivable financing is conducted on a non-notification basis, the pattern of associated non-financial services obtained by the borrower is quite different. This fact derives largely from a difference in the nature, and thus in the financial and other needs, of the commercial finance company's clientele.

First, the non-notification client obtains no guarantee against credit losses; therefore the client must assume the responsibility for selecting credit risks through his own established

credit department. It is possible, of course, for the client to obtain credit insurance but this procedure appears to be less frequently utilized than might be expected. Second, since the commercial finance company does not guarantee the credit risks on the receivables it acquires, its interest in the *quality* of the paper is somewhat less intense than is the factor's. The commercial finance company and the bank are interested in the quality of the receivables in order to determine the percentage advance to be made. However, even very poor paper may be accepted on a low percentage advance basis. All that is important is that the lending agency should be able to *estimate* the prospective quality of the receivables with reasonable accuracy and to require the borrower to absorb the losses arising therefrom. Finally, since customers are not notified of the sale or assignment of their accounts, the borrower must make all collections and handle the receivables bookkeeping.

On the positive side, it is of considerable value to the borrower to have the commercial finance company report regularly on the general quality of the receivables offered for sale or as loan security. Through these reports the borrowing company gets an objective opinion on the quality of the risks accepted by its own credit department and the effectiveness of its collection procedure. The supervision of current loans often provides for the preparation of reports to borrowers that give a clear statement of changes in the quality of receivables generated and in merchandise returns and allowances.

In further contrast to the client of the old-line factor, the non-notification borrower never contracts for merchandising and selling services in addition to the funds advanced. But while it is generally true that the concerns obtaining non-notification financing are primarily seeking working capital funds, it is stated by experienced officers of lending agencies operating in this field that many of the clients of the commercial finance company are as much in need of management advice as of funds. The need for the latter may, in fact, be merely the reflection of defective management. Consequently all commercial finance companies emphasize the importance of

this management counseling phase of their functioning, indicating that it ranges over financial, merchandising, production, personnel and all other aspects of business operations. In some instances commercial finance companies have a special department to handle this part of their work; some provide the service at a stipulated fee or retainer, although this is the exception rather than the rule. In most cases where the counsel is offered it is supplied in a more informal way and the cost of providing it is absorbed in the regular financing charge.

It is obvious that every lending agency is interested in the management and general efficiency of the client's business but, conventionally, this interest is based mainly on the importance of management as a determinant of credit standing. The loan is made if the management is considered adequate and rejected if the opposite prevails. On the other hand, many of the non-notification finance company's clients would be rejected if such standards were applied. As a result, this type of agency necessarily adopts a more positive interest in management. The borrowing concern's personnel is appraised as regards efficiency but, beyond that, steps must be initiated to *correct* defects in its policy and general administration. If this requires an overhauling of the borrower's business, then this can be, and often is, undertaken. If the commercial finance company could not approach the financing problem from this point of view, and if it were not willing to make this effort, its field of action would be restricted to a considerable extent.

6

Policies and Procedures

LIKE THE FINANCING of instalment receivables, open accounts receivable financing is a *mass* financing operation. This is of primary importance to any examination of the credit standards and credit appraisal techniques that are adopted by the financing agency. The fact that a great many individual transactions must be handled expeditiously means that a routine procedure is established for checking the credit quality of the collateral. In this respect the policies and procedures followed by factors and commercial finance companies are very much like those adopted in instalment sales financing. The analogy is less close when applied to commercial bank operations.

The internal organization of agencies engaged in financing accounts receivable is determined mainly by the range of the services offered, the volume of the business transacted and the character and extent of activity in other financing fields. Since the concerns operating in the field show considerable differences in these matters, it is difficult to generalize regarding their internal organization and operating procedures. In the following sections, however, certain broad differences between factors, commercial finance companies and commercial banks will be indicated.

Organization and Personnel

We shall describe, first, the general scheme of organization of the factoring company. Obviously the larger the volume of business transacted by a factoring company the more specialized the departments[1] that will be required. Factors usually

[1] The word "department" is used here in the management organization sense. It should be noted that the word is frequently used in the trade to refer to the different mills or accounts for which the factor *cashes* sales. An "inside" department, in this sense, is one for which the factor provides storage space and showroom facilities in the factor's building; an "outside" department does not use these facilities.

establish a fairly rigid internal organization, the main outlines of which are determined by the several functional aspects of the factoring operation. Since these functions are common to all concerns, there is a general similarity in organization.

The credit department is the crucial department in the whole factoring organization because of the factor's assumption of the credit risk on purchased receivables. Its successful operation depends on supervision by well-qualified credit analysts with intimate knowledge of the factor's clients and the customers served by them, and a clerical staff able to maintain a high degree of accuracy and order in handling a mass of individually small transactions. Also, credit executives must be available to negotiate with clients and customers for carrying through exceptionally large transactions. The work of analyzing the financial statements of clients and providing guidance on financial budgeting is sometimes organized in a special division of the credit department.

Specialization within the credit department is frequently necessary because the factor serves more clients than can be handled by one credit man and may cash receivables for a wide variety of concerns. Although it is difficult to estimate the number of clients served by any particular factor,[2] it appears that this may be as high as 400 or as low as 50; the accounts of various clients doubtless vary considerably with respect to activity and number of receivables involved per $1000 of sales cashed. Since the contract between the factor and his client stipulates that sales and deliveries are to be made only with prior approval of the factor, the credit department must be equipped to act promptly on any request for clearance. Consequently, there is a considerable gain in efficiency when the department is organized to assign certain individuals to the business of certain clients. After a time the credit man gets to know his clients' trade customers and credit problems so well that he can give an immediate decision on a request. Also, the

[2] If the account is a selling agent it may represent sales of a number of mills.

factoring companies that have extended their services beyond textiles must employ somewhat different credit standards and procedures, necessitating further specialization in the credit department.

The very large amount of mailing involved in factoring requires a special mail department. This department's existence grows mainly out of the need for careful handling of outgoing invoices represented by cashed sales and the receipt of payments on invoices. In most instances the client mails invoices to customers but this is not always the case; in any event, the factor receives the customer's payment and organizes a department to handle this specific phase of the whole operation. These collections involve an impressive mass of detail.

In addition to these functional divisions of the factoring company there are other functions that may be departmentalized, depending on the size of the company. An accounting department is needed for the verification of invoices and schedules of accounts submitted by the factor's clients; the calculation of discounts and average due dates on accounts purchased; the maintenance of bookkeeping records on invoices purchased and payments, credits and offsets against these accounts; the calculation of the amount of the reserves to be maintained on the accounts of different clients; the keeping of clients' debit and credit balances; the preparation of the statements presented at intervals to the clients. The factor must also maintain a department to watch maturities, to collect delinquent accounts and to prepare and file claims against insolvent debtors. Supervision over these various departments is usually exercised by officers of the factoring concern; other officers participate in the promotion of new business activity, in the maintenance of the concern's banking relations and in the general management of the company.

Despite marked similarities, the organization of the non-notification financing company differs somewhat from that of the factor. This is due principally to differences in the receivables financing services rendered, and to the fact that the commercial finance company is a less specialized financial

agency than the factoring company, both as regards the industrial characteristics of its clients and the types of financing it conducts. Aside from the purchasing of trade accounts the factor's only other credit-extending function is in making loans on merchandise and on receivables assigned by the client under a recourse agreement, but the finance company may buy open accounts, make advances on merchandise, discount instalment sales contracts for manufacturers and dealers in industrial and commercial equipment and, in some cases, discount contracts arising out of instalment sales of consumer goods.

In order to carry on these diversified activities effectively, the finance company is organized in departments according to type of business. For its accounts receivable financing, it maintains a clerical staff to receive schedules of accounts, determine the credit rating of individual accounts, ascertain their cash or loan value, receive payments on accounts previously acquired, and maintain current records of collateral held for each client and records of each of the client's trade customers. There are usually several credit men attached to this division whose function is to make the original investigation of new accounts and examine each schedule as received, and one or more officers authorized to make disbursements. In addition, there must be an accounting or controlling division to prepare monthly statements for clients, legal and collection departments, and a new business division, if the company is large enough for this degree of departmentalization. The auditing force is of strategic importance to the finance company. This may consist of a division or even a separate corporation (operating under name and address different from the finance company in order to maintain the secrecy of the receivables' sale) which sends out audit slips to trade debtors asking for verification of receivables. Under this department there is an outside auditing force responsible for frequent examinations of the clients' records and general progress. Finally, some commercial finance companies now have separate divisions or departments through which they provide general management counsel to their clients.

The magnitude of routine procedures (for example, the verification of accounts) may be gauged from the fact that even for one of the smaller commercial finance companies with outstanding advances of $1 million there will be approximately $1.5 million of receivables held at all times, which means 15,000 separate invoices if the average is $100 each. A company of this size would employ from 15 to 20 persons in all. Another company, doing approximately $30 million in receivables financing annually, reports that it employs 150 people.

The organization of accounts receivable departments in commercial banks varies mainly with the amount of business handled and the method of operation followed. A bank having only five or six such accounts handles these along with other lending activities and without any special departmentalization. Some one of the lending officers will exercise general supervision over the accounts, but detailed work is done in the regular discount department. Credit investigation on accounts is made by the credit department, with possibly one outside man responsible for conducting periodic audits, along with other duties.

In a few banks, however, a more formal and definite organization has been set up. The procedure in these cases follows almost exactly that of the commercial finance company and is, in a few cases, incorporated in the instalment credit division. Commercial banks in general tend to make less detailed examinations of their accounts than is characteristic of commercial finance companies; thus the organization is correspondingly simplified. Where the volume of loans made is high, say $1 million or more per annum, the senior lending officer in charge has often had finance company experience. The organization that this officer develops—for the promotion of business, making credit investigations, keeping records of loans on assigned accounts and repayments thereon, verifying assigned accounts and calculating interest charges—is necessarily similar to that found in the commercial finance company. However, an exception to this general description of organization should be

noted. A few banks have adopted procedures that substantially reduce the amount of detail involved in handling receivables loans. In some cases this is done by placing a custodian in the office of the client and, since this makes it possible to shift the location of most of the detailed accounting work, the work performed in the banking office and, correspondingly, the number of persons employed by the bank to service these accounts, is greatly reduced. In other cases the bank takes an over-all assignment of all receivables and, not keeping individual records for trade debtors, has a much simpler organizational plan.

Methods of Acquiring Business

Factors and commercial finance companies, especially the latter, are more aggressive than commercial banks in seeking to expand their receivables business. This is not surprising, since the banks make loans on open accounts as part, and most frequently as an unimportant part, of a broader lending program while the other agencies are specialists in receivables financing. All the factors maintain promotional or new business departments and advertise their readiness to serve as factors, but the relatively heavy concentration of their activities in textiles results in their advertising mainly in specialized textile trade journals. Their industrial specialization, and the fact that nearly all factoring companies have either been established in the field for many years or represent mergers and consolidations of long-established concerns, have made them so well known, and the financing service they render is so conventional, that there is little need for promotional activities of an educational sort.

On the other hand, the commercial finance company is newer in the field and its methods of financing are less well known. Furthermore, its financing "plans" are by no means generally accepted by potential business borrowers and competing financing agencies. Consequently, the commercial finance company must go to considerable effort and expense to explain the character and relative cost of its facilities. Another reason for the more aggressive promotional activities of commercial

finance companies is the fact that their potential borrower market is more widely distributed industrially and calls, therefore, for more widespread advertising effort. One of the large companies, for example, uses spot radio news programs and national weekly news magazines as advertising media, However, most companies depend on field sales effort and the distribution of prepared booklets descriptive of their facilities; officers of these companies maintain that their new business comes to them primarily as a result of established contacts with clients and that their services are generally sought out by the borrowers. Such clients are frequently referred to finance companies by commercial banks that are unwilling to lend on the basis of the security offered.

Some of the commercial finance companies, particularly the small local companies, pay fees to individuals who bring acceptable accounts to their attention. This commission, usually earned by businessmen, lawyers and auditors who are said to have "sold" the accounts, is generally 10 percent of the gross charges to the borrower and continues as long as the account is handled by the finance company. It is analogous to the "finder's" fee paid by investment bankers to persons who bring them new "deals." It should be noted, however, that this practice is not followed by the larger commercial finance companies, and that, in any case, only a few accounts are acquired in this way.

Because of the relatively limited interest of banks in accounts receivable financing, their methods of acquiring such loans differ quite widely from those of finance companies and factors. Except for those few banks that have made special efforts to develop this field, accounts receivable financing is provided either as a convenience for a few customers or as a special device for liquidating or "working out" a loan that was made previously on some other basis. Banks whose activities in accounts receivable financing are of this sort are not at all interested in advertising these facilities. Indeed, some bank officers who have made loans under such circumstances are convinced that the accounts receivable loan is not a satisfactory

asset and that such lending is not a proper bank function. They argue that the borrower who can get funds only on an assignment of accounts receivable is not an acceptable commercial bank risk.

However, an increasing number of banks are sufficiently interested in accounts receivable loans to be making some effort to increase the scope of their activities. Few banks attempt to reach outside their natural trading areas to acquire loans of any type except through correspondent relationships. Commercial banks, therefore, face a markedly different promotional problem from that of the national or regional commercial finance company. A few banks have established sizable departments and carry on rather widespread advertising and field sales promotion activities, but these institutions are exceptional. One bank reports that it has acquired or sought loans by going over rejected loan applications and classifying the businesses in its locality according to relative credit standing, selecting for further study those with a rating considered too low to make them potential borrowers on an unsecured basis. It was found, of course, that most of these concerns would be ineligible as borrowers on any basis. But those that proved to have acceptable receivables in sufficient amount, and seemed able to use additional funds for taking trade purchase discounts, were approached by the bank to become borrowers on a receivables basis.

Finally, commercial bank officers are divided rather sharply as regards the continuing usefulness of accounts receivable financing for a particular firm. Some bank officers view the arrangement as primarily an interim method of financing; the officer expects the borrower within a limited time period either to improve to a point where funds can be advanced on some other basis or to get out of debt to the bank altogether. Of course, this view does not preclude a continued investment by the bank in receivable loans, in spite of an expected rapid turnover in borrowers. On the other hand, some bank officers feel that a business may properly borrow continuously on this basis so long as satisfactory receivables are generated. What-

ever the case, the attitudes of bank officers on questions of this sort are the primary considerations affecting the aggressiveness with which they seek to expand activities in this field of financing.

Formulation of the Financing Contract[3]

Since receivables financing—whether it is notification (non-recourse) factoring of sales, or the purchase or assignment of receivables on a non-notification (recourse) basis—usually contemplates not a single loan but a continuing relationship between the parties involved, it is especially important that the conditions to be fulfilled by both parties be carefully and explicitly stated. These terms and conditions are usually stated in a formal contract or loan agreement the nature of which differs for different agencies, reflecting differences in the services offered. These differences are particularly marked when the contract or agreement between factor and client is contrasted with the usual non-notification contract.

The Factoring Contract

The contract under which the factor agrees to purchase accounts receivable usually takes the form of a letter to the client giving the details of the arrangement. Its main provisions are substantially uniform among different factoring companies, though there are differences in certain of the provisions.

First, the agreement provides that the factor is to purchase and assume credit risk on all the accounts receivable originated by the client. In view of the assumption of risk, it is essential to stipulate that all sales must be approved in writing by the factor's credit department and that the invoices must be accepted without dispute by the client's customer before the assumption of risk goes into effect. While it is the usual practice for the factor to insist on cashing *all* of the client's sales, exceptions are found where, for example, a client operates a number of mills producing distinctly different lines of merchandise. Clearly, this practice is followed as a risk-limiting

[3] The discussion of contractual arrangements is based on examinations of contract forms made available by several financing agencies and on conversations with their officers.

device: it prevents the client from withholding sales to superior firms, assures the factor that the average risk undertaken will be lowered by the inclusion of these low-risk sales, and gives the factor's credit department the exclusive privilege of selecting risks. It also avoids the confusion that would arise in customer relations if some invoices were payable to the factor and some to the client. Related to this provision of the factoring contract are others requiring that the factor remit to the client, either upon the latter's request or upon the factor's own initiative, the net proceeds due the client on sales cashed; it is stated in the contract, however, that this does not affect the right of the factor to withhold sufficient funds to maintain a reserve against merchandise returns, claims, allowances, and other offset or "contra" items that may arise out of cashed sales and for which the factor is not responsible.

Second, the factor's contract provides for presentation to the client at stated intervals, usually monthly, of statements referred to as the "account of sales" and "account current." The account of sales is a summary of the sales of the client for any given month and is presented usually between the tenth and fifteenth of the following month. It gives sales cashed, net of returns and allowances and of the discounts allowable to customers, which represents the maximum amount the factor can expect to obtain from purchasers. Since funds are to be supplied to the client prior to the maturity of the sales, the invoices must be given a present value by discounting them, usually at the rate of 6 percent per annum, for a period extending to their average due date [4] plus a ten-day period which provides for ordinary delays in customers' payments and clearance of checks. The client is also charged in the account of sales (by means of a deduction from the net value of the sales) with the factor's commission which is computed on net sales and is charged as of the fifteenth of the month, on the assumption that sales are distributed, and commissions earned,

[4] The average due date is an average of the number of days each receivable has to run from the date on which the account is rendered to the invoice's maturity date, weighted by the amount of the invoice.

equally over the month. This whole calculation produces an amount which is credited to the client as of the date on which the account of sales is computed—usually the last day of the month.

The factor also renders monthly an account current, in which the client is credited with the resultant amount calculated in the account of sales, and in which the client is debited for funds withdrawn by him, remittances made on his behalf or funds supplied to him in excess of those available from purchases of sales, such as advances on merchandise and other items properly chargeable by the factor. Finally, in the account current the factor may charge his client an additional commission or fee of 1 percent of that amount of the returns and allowances to customers on the client's account that exceeds 10 percent of the client's sales. This fee is usually computed for a six-months' period in order to avoid making charges for erratic short-period changes in the amount of returns and allowances. The account current bears interest, pro and con, generally at 6 percent per annum.

The third main provision of the factor's contract states that the trade receivables are assigned to the factor "in absolute ownership," which means that the assignment conveys to the factor a property interest in the merchandise sold and enables him to exercise all the rights of an unpaid seller, including rights of replevin, reclamation and stoppage in transit. Also, the contract states that the factor is not liable for any damages arising out of his refusal to approve shipment or delivery of goods.

Fourth, the contract establishes a procedure to be followed in handling customer invoices. These are prepared by the client and mailed out either by client or factor, under the factor's return address. The invoice carries a notation that it has been sold to a stated factor and is payable to that factor at a stated address; this constitutes "notification." The client is further required, by contract, to deliver to the factor duplicate invoices for each transaction and official bills of lading, shipping receipts or other satisfactory evidences of shipment or

delivery. Credit for sales cashed can be given only upon receipt of such documents. The obvious purpose of these precautions is that all accounts purchased should represent *bona fide* approved sales of merchandise actually shipped to the customer or to some delivery point designated by him.

Fifth, the contract usually contains a provision regarding the settlement of disputes between clients and their customers with respect to merchandise sold. The client is required to notify the factor immediately of any merchandise dispute and must try to settle or somehow adjust such differences, notifying the factor of the outcome. If the dispute remains unsettled at the maturing date of the invoice, the factor is permitted to charge the amount back to the client's account together with interest from the due date of the invoice and to deduct any expenses incurred by the factor. Also, the client agrees to give the factor immediate notice of any returned, rejected, or recovered merchandise and to repay the factor for the amount credited to his account that arose out of the original sale of these goods. Pending such payment, the factor actually owns the returned merchandise and reserves the right to dispose of it in order to settle his claim. Furthermore, the factor has right to, and ownership of, any accounts receivable arising from the subsequent sale of returned merchandise.

Sixth, if any remittances are received by the client these must, according to contract terms, be turned over to the factor in whatever form received. In this connection, the factor reserves the right to endorse the client's name on any and all remittances received by him if such endorsement is necessary to effect collection. The client is also required by contract to keep proper books of account regarding sales, claims and losses on merchandise and to give the factor access to these at all reasonable times.

Seventh, in some cases the factor's contract provides for advances of funds on the security of the client's merchandise. The factor, however, reserves the right to determine the amount and term of the advances, evaluate the collateral security and set the ratio of amount advanced to collateral

taken or to the client's sales volume. In connection with the advances the client agrees to take inventory twice a year, or more often, and agrees to do whatever the factor requests in the way of leasing warehouses, placing signs on merchandise, and filing notice of lien, and, of course, the client is bound not to dispose of merchandise on which the factor has a lien without permission from the latter.[5] The factor maintains a continuing interest in the merchandise, including a lien on any accounts receivable or other proceeds arising out of their sale.

Other provisions of the factor's contract cover interest rates chargeable on merchandise advances, commissions to be levied on sales, the client's obligation to meet expenses incurred in disposing of merchandise taken as collateral for advances, insurance to be taken out by the client on pledged merchandise and, finally, the conditions upon which the contract is to be terminated.

Commercial Finance Company Non-Notification Contract

The contractual agreement between the non-notification financing company and its clients sets forth, first, that the finance company agrees to purchase accounts[6] acceptable to it, to make a payment up to a certain percentage of the face value of the accounts, and to pay the remaining percentage upon the full collection of the account less any deduction and plus any overpayment by debtors. In turn, the client agrees to execute an assignment whereby the finance company acquires full and absolute title to the accounts, and all the rights of the client as regards the merchandise from the sale of which the account originated.

Second, the fee or charge to be levied for this service is stated and the conditions of its payment are indicated. The commercial finance companies usually quote their charge as a fraction of 1 percent, frequently 1/30 or 1/40 of 1 percent,

[5] In New York State the validity of the factor's lien depends on the completion of all these steps, as set forth in the Factor's Lien Law.

[6] Accounts may be defined in the contract to include open accounts receivable, book debts, notes, acceptances, drafts, contracts or other choses in action. The discussion relates to a purchase and sale type of agreement, since this is used generally by commercial finance companies.

of the face value of accounts purchased for each day the account is held by the company.

Third, the agreement provides that no payment need be made by the financing agency on accounts purchased if the client violates any one of the provisions of the contract with regard to any outstanding account.

Fourth, since the commercial finance company does not assume the credit risk on purchased accounts, as does the factor, the contract states fully the terms of recourse on the client if acquired accounts go into default. This is effected by having the client agree to notify the finance company of any act indicating or amounting to business failure or suspension on the part of any customer indebted on accounts it has sold to the finance company and promptly to pay the finance company the amount of the relevant account. Further, the client agrees to pay to the finance company the amount of any account held by the latter which is not paid on or before its due date. Like the factor, the commercial finance company attempts to protect itself from losses on accounts purchased by requiring that the client pay the full amount of any account if the merchandise which it represents is returned or if any dispute arises concerning the sales transaction. Also, the commercial finance company requires that returned merchandise on its accounts be held by the client in trust for the finance company and be purchased by the client at original invoice value. The client is also required to guarantee that the accounts represent *bona fide* sales, that they are not subject to any set-off or counterclaim and to agree that the payment of the account is not contingent upon the fulfillment of any other contract or condition.

Fifth, commercial finance company contracts generally provide for the maintenance of a number of other conditions calculated to give protection to the finance company. Specifically, the client agrees (a) not to sell or assign any of its accounts to any party other than the finance company named without giving 30-day written notice of intention to do so, (b) to indicate on his sales ledger the accounts sold or assigned, (c) if requested, to open mail only in the presence of a repre-

sentative of the finance company, (d) to give the finance company the right to endorse the name of the client on any remittance received by it on the account of purchased receivables, where necessary to effect collection, (e) to give the finance company access to its books, records and customer correspondence at all reasonable times, and (f) to give the finance company the right to retain, as security against loss on accounts purchased, any account, property or moneys of the client assigned to or coming into the possession of the finance company, and to apply these assets or their proceeds to the liquidation of any outstanding overdue or disputed accounts.

Sixth, separate provisions of the contract authorize the client to make collections on accounts purchased by the finance company although this authority may be revoked by the latter at any time; the client is obligated to deliver immediately to the finance company all remittances received on accounts sold to the latter.

Seventh, the contract provides that if the client defaults in the performance of any provision of the contract, if he suspends business, if he files a petition for reorganization, or has such petition filed against him, if a receiver for his property is appointed, or if any act occurs amounting to a business failure by him, he is obligated to repurchase from the finance company all accounts held by the latter at the aggregate principal amount of these accounts plus any charges having accrued upon them. Should the client fail to repurchase the accounts in question, the finance company reserves the right to sell them and to reimburse itself out of the net proceeds of the sale. Finally, it is customary to provide that the contract shall terminate at the discretion of the finance company, if the client is in default, and at any other time at the discretion of either party, on 30-day notice.

Commercial Bank Non-Notification Agreement[7]

Where the open accounts financing of the commercial bank is

[7] This section is devoted exclusively to non-notification agreements because it is very exceptional for a bank to engage in factoring on a non-recourse and notification basis. Also the discussion relates to the taking of assignments of

conducted along lines broadly similar to those followed by the commercial finance company, the loan agreements utilized by banks are necessarily similar to those of the finance companies. This section deals only with this customary type of loan agreement. It should be noted, however, that some banks have made efforts to simplify procedure and these use a different form of agreement.

While there are differences in the bank loan agreements in use, due mainly to the law of the state in which the bank operates, certain common features are clearly observable. Like the finance company arrangement the usual bank contract does not require that all of the client's accounts be assigned, but rather that the client provide a listing of accounts to be assigned and transfer to the bank full title to these accounts and all rights in the merchandise out of the sale of which they were created.[8] The client must also guarantee that the assigned accounts represent *bona fide* sales, that they are not subject to counterclaims, etc., and that the assignor has full right to effect their assignment. The bank generally requires a statement in the contract giving it power of attorney for the client to provide for receipt of funds from trade debtors, endorsement of receipts, settlement of claims, collection of accounts, etc.

The bank usually retains the right in its loan agreement to notify trade customers and to make direct collections, but in practice the borrower's customers are not notified unless default seems imminent. The client is necessarily permitted under the loan agreement to make collections on accounts assigned.

[8] The contract sometimes used in an attempt to reduce the steps of the receivables financing operation to a minimum requires that *all* the borrower's receivables be assigned or a certain block of receivables. This fact eliminates many of the provisions of the usual contract that have to do with the handling of *individual* invoices. Of course, the shorter contract form still provides for the exercise by the lender of dominion over remittances, protects against the commingling of funds and contains the usual conditions relating to the terms upon which advances will be made on receivables. Even these conditions are not always incorporated in the contract, which is a simple agreement to assign, but may be left for supplementary agreements.

---

receivables as collateral for a loan balance, although some contracts are expressed like those of commercial finance companies, that is, as purchase and sale agreements.

This fact, namely, that under any non-notification arrangement the borrower must make collections, raises two important problems for the bank. There is the practical matter of assuring itself that collections are wholly and promptly turned over to the bank. Then there is the legal consideration that, in order to establish and maintain its lien on the assigned receivables, it must be clear that the borrower exercises no dominion over the funds collected and that they are not commingled with the borrower's own funds.[9] The bank may attempt to take account of these conditions: (1) by providing in its contract or in supplementary agreements for the appointment of an agent or custodian in the office of the borrower, who, as a bonded employee of the lender, is responsible for the receipt and custody of funds paid on assigned accounts, or (2) by requiring that it receive, or at least have presented for inspection, the payments on assigned accounts in the identical form in which they are received from trade debtors, and that the receipts be deposited as general security in a special cash collateral account from which the bank alone is able to order disbursements.

In addition to the above elements of the loan agreement, it is generally the case that the borrower is required by contract to mark on his ledger the assigned account, perhaps to maintain a separate ledger of assigned accounts, to agree to a percentage to be advanced on receivables assigned and to the charges to be levied on funds advanced, and, finally, to agree to substitute new accounts acceptable to the bank for any accounts proving to be unacceptable as collateral security, or to make payments to the bank sufficient to cover their net face amount. The agreement must state, of course, the grounds upon which an assigned account may be judged as unacceptable security. These grounds usually include delinquency on the part of the trade debtor, a dispute over merchandise or its delivery, or acts indicating or amounting to business failure or suspen-

[9] The exercise of dominion and the commingling of funds would occur, respectively, if they were diverted by the borrower to his own uses or deposited in his bank account.

sion by the trade debtor. If the borrower does not make the payment or substitution, the bank frequently can exercise its right, reserved in the loan agreement, to apply all or part of any deposit account of the borrower to the liquidation of the indebtedness.

Other provisions of the loan agreements generally characteristic of contracts, and of collateral loan agreements, include an acceleration clause concerning the bank's right to dispose of collateral in order to liquidate the borrower's obligation, a clause stating the lender's rights with respect to returned merchandise, and a statement of the conditions under which the agreement may be terminated. Clauses having to do with the borrower's obligation to take out credit insurance on accounts are sometimes included, but this is by no means a frequent loan agreement feature. Finally, the borrower is specifically obligated to furnish certain financial statements and to give the bank access to records and premises on reasonable conditions.

Credit Analysis and Standards of Commercial Finance Companies

In accounts receivable financing the credit problem consists of three main parts: making careful appraisals of initial applications, setting credit standards that provide adequate margins of safety on current advances and loans, and following carefully the client's operations while the financing arrangement is in force. Each of these aspects of the credit problem is present in both factoring and non-notification financing, although they may receive different emphasis in the two types of financing. Since the factor buys the accounts of clients without recourse, the quality of the open account is the primary concern, although the client's financial condition is also always a matter of interest to the factor. In non-notification financing the general moral and financial risk presented by the borrower is naturally important because the accounts are bought with recourse but, even so, it cannot be said that the primary interest is in the client's statement as contrasted with the

quality of the receivables assigned. The client's financial condition may be of primary concern to those commercial banks taking accounts on assignment as secondary rather than as primary security. In finance company operations the emphasis is on the quality of the receivables acquired and the moral risk involved. This is purely a matter of emphasis, however, for each financing agency necessarily takes account of all aspects of the credit risk.

A review of the more important credit appraisal techniques and standards of receivables financing will show that they are very different, in many ways, from those characteristic of other types of business financing. Furthermore, the methods followed vary considerably among the different agencies. Since a detailed statement of these differences would be extremely lengthy it has been decided to devote most attention to the methods broadly characteristic of commercial finance companies and to follow this with a shorter statement of the operating methods of commercial banks. In order that as many as possible of the steps in the credit appraisal process may be brought into the discussion, the following statement of commercial finance company practice is prepared on the assumptions that the investigation relates to an application involving a high degree of risk, that it is to be as thorough as the most experienced agency can make it, that the financing agency has had no previous experience with the applicant and that accounts are to be taken on assignment without notification and with recourse on the client.

Appraising the Client

A complete investigation of an application for receivables financing is a costly procedure and it is therefore customary to make a preliminary sifting of requests. To this end the applicant is requested to submit financial statements covering a period of three or more years. Although credit officers were questioned carefully on this matter, there seem to be no generally accepted minimum standards that these statements must meet as regards financial ratios. On the contrary, there is rela-

tively little emphasis placed on financial ratios *per se*. Risks may be accepted where financial statements show unfavorable ratios, if there are underlying circumstances suggesting improvement. It is by no means unusual for accepted clients to show current ratios of 1 to 1 or $1\frac{1}{8}$ to 1, or even net worth deficits. In some instances applications are accepted from concerns in receivership although such cases are not frequent and carry special conditions such as subordination of other creditor claims, and possibly the assignment of inventory as well as receivables. All of this suggests that financial ratios are considered of secondary importance, as might be expected since specific collateral is pledged against the loan. In this respect, although not in others, receivables lending is closely analogous to mortgage financing, for in both fields the credit analysis is focused more on the collateral than on the financial position of the client. The considerations that seem to weigh heavily in receivables financing are (1) the moral risk involved, (2) the quality of the concerns to which the applicant sells goods, (3) the general competitive position of the applicant, (4) the amount of funds that can be kept at work in the account and (5) the general financial position of the applicant. If this preliminary analysis shows that the applicant has acceptable receivables to be pledged, that a valid lien on the receivables can be obtained, that there is a reasonable amount of net worth in the business, that the advances will enable the client to take discounts on purchases to an extent that will make the financing beneficial and that the applicant will utilize sufficient funds to make the arrangement profitable for the lender,[10] the more comprehensive credit analysis is initiated.

The detailed examination of the applicant is generally conducted by the financing agency's own field auditing staff. It is customary, first, to submit the receivables to careful analysis. The investigator's report shows the volume of sales made

[10] There are differences of opinion on this point, but it is unlikely that an account would be taken that could not employ $5,000 or more as an average loan balance; some companies feel that they must have at least $25,000 in use continuously in order to make the loan profitable to them.

on open account and provides a classification or "aging" of outstanding accounts receivable into those not yet due ("current") and those overdue. Overdue accounts are classified by the degree of their delinquency, for example, 1–30 days, 31–60 days, and over 60 days past due. Similarly, the report provides an aging of notes receivable, including separate study of any instalment receivables or lien instruments held by the applicant against which advances may be sought or which may be assigned as additional security. An effort is made to learn the reason for the creation of notes receivable and to determine whether they have been renewed; in many cases these notes grow out of long overdue open accounts, a condition that affects considerably their acceptability as collateral.

Another phase of the investigation has to do with the applicant's sales record. The audit shows annual gross sales for two or three years at least, the amounts collected in each of these years, the amounts allowed customers for trade and cash discounts, the total allowances for returns of merchandise and other credits and, finally, the amounts charged off as losses. These are frequently difficult analyses to make but they are essential for the determination of the appropriate percentage of the face value of receivables to be advanced. If the sum of the items deductible from gross sales should represent, on the average, 5 percent of the gross amount of sales, then the lender might decide to place the advance at 75 percent, allowing the additional 20 percent as a margin to cover the difference between the client's costs and the price of goods sold and to absorb losses not otherwise allowed for.

The examination usually includes a determination of the amount and condition of the inventory, the physical conditions under which it is being held, the propriety of the valuation methods used by the applicant, and a complete verification and valuation of the inventory. These steps are taken even if it is not anticipated that advances are to be made on inventory, and are especially important if such advances are to be made. Further, the analysis states the cash position of the firm and provides a reconciliation of cash with bank deposit

statements; a careful study of cash receipts and disbursements is made in order to uncover any unusual entrepreneurial withdrawals or other payments.

The general audit also evaluates fixed assets and states the applicant's practice with respect to reserves for depreciation, but these facts are not reported in detail because they are not of immediate relevance to the credit problems presented by accounts receivable financing. A reasonably accurate appraisal of the fixed assets and of their general physical condition is required, mainly for the light it throws on the technical adequacy of the concern as a productive enterprise.

Among the liabilities, particular attention is given to the condition of accounts and notes payable and to the maturity schedules of the applicant's debts. A detailed analysis of the applicant's outstanding payables gives a breakdown according to creditor, date of origination, maturity date, amount and interest rate. Notes payable to trade creditors are analyzed separately since these may have arisen out of the applicant's inability to meet open accounts at maturity. Trade accounts payable are "aged" in an analysis comparable to that prepared for accounts receivable, and a special listing made of any particularly large or otherwise unusual items. The company must also state the terms on which it makes purchases on open account, for this can be used to determine whether the applicant can profitably borrow against its accounts receivable; that is, it may be that the cost of receivables financing is covered or even exceeded by the savings effected by the concern's availing itself of cash discounts on purchases. The audit also gives a schedule of other liabilities, including bonds and mortgages, taxes and other expenses payable, and any contingent liabilities to which the applicant is exposed. Finally, the report shows the capital and surplus of the applicant and the principal adjustments in the surplus account made in recent years.

The applicant concern is customarily requested to provide a detailed profit and loss statement covering a period of at least the last three years, and special note is taken of any

aspects of the concern's record that seem unusual in the way of expenditures or receipts, taking account of the amount of business done. Credit officials of commercial finance companies emphasize the importance of the income statement for this enables them to make a judgment concerning the general efficiency of the concern, the probable causes of any loss, the amount of financing probably required, and the general prospects for the applicant as a business enterprise. In this connection it is well to note that the financial statements are particularly meaningful, and their analysis relatively easy, if the applicant is engaged in a line of business that is well known to the credit analyst and one to which empirically established standards can be applied.

Aside from this analysis of the prospective borrower's financial position, it is sometimes necessary to examine carefully the more important non-financial aspects of the company's operations. Thus cost studies may be made as well as analyses of the products sold and the distribution methods and policies followed. Often the applicant is required to engage the services of an outside agency to make the required study; some commercial finance companies, as pointed out above, have special personnel for such purposes.

Finally, it is important to emphasize the nearly universal agreement that the main risk taken in non-notification receivables financing is the risk of fraud. In the first place, the applicant is usually much in need of funds. In the second place, the non-notification scheme, since it necessitates borrower collections on collateral, provides opportunities for taking advantage of the lending institutions. The principal varieties of fraud are: assignment of fictitious accounts (perhaps accompanied by forged shipping documents); duplicate or triplicate assignment of the same accounts; diversion of collections to the client's own uses (perhaps accompanied by large and unusual officer withdrawals); failure to report regularly and accurately the amounts credited to customers for returned merchandise, trade and cash allowances and discounts, offset or contra items (these making for overstatements of the value

of receivables); finally, submitting false financial statements. This is by no means an exhaustive list of ways in which fraud is perpetrated in this business but it serves to illustrate why the financing agencies make careful investigations of the honesty of the principals involved.

Appraising the Collateral Security

The next step in the accounts receivable credit analysis focuses on the quality of the applicant's receivables. For analysis of the customers of the applicant (that is, of the collateral security available), the investigator obtains a credit rating from some one or more of the credit-rating agencies. If the average size of the receivables is very small it may be feasible to examine only into the group experience but usually individual ratings are assigned. The customers can then be classified into categories of acceptable ("rated") and non-acceptable ("off-rated") accounts according to the credit standards established by the financing agency. Not every agency sets up the same standards in determining the acceptability of a given group of accounts receivable, but the basis of the standard, namely, the mercantile credit rating, is usually the same.[11] Frequently, there will be some concerns among the applicant's clients that are not listed in the credit agency rating books and some that are listed but for which ratings are not available. Both of these groups may be classed as off-rated but, since they are likely to be small in individual amount, they may also be classified as acceptable. In general, the financing

[11] One division of credit ratings that is used frequently includes all concerns with a Dun & Bradstreet "limited" general credit rating (regardless of estimated pecuniary strength), and all with a "fair" general credit rating (excepting concerns whose estimated pecuniary strength is placed at G, H or J) in the off-rated classification. All other concerns would be considered as rated and acceptable. This represents, it would seem, a fairly conservative classification of mercantile credit risks. Other agencies classify only those concerns with a limited general credit rating as off-rated accounts. A still more liberal credit standard would be to include as rated accounts even those concerns with the lowest (limited) general credit rating provided they have an estimated pecuniary strength of $2,000 or less; this standard would be justified on the ground that such accounts would necessarily be very small and that the loss on them would be both moderate and forecastable provided a sufficient volume of them can be obtained.

agency takes all the rated accounts and accepts only a certain percentage of the off-rated accounts, although the percentage of off-rated to rated accounts is kept flexible and is altered to meet the special circumstances of various applicants.[12]

In addition to determining the acceptability of receivables, the average size of accounts is calculated in order to determine the amount of detailed record keeping that will be required. The geographical distribution of sales is determined and any tendency for sales to be concentrated with a few buyers is noted. Where some accounts are particularly large the preliminary examination may call for a special mercantile credit report on the buyer.

Another measure of the quality of receivables is their collection period. This can be computed by relating outstanding accounts and notes receivable, over a period of time, to data on sales and collections. The collection period is used in setting a maturity for loans secured by receivables; data on sales are used to calculate the volume of financing that the borrower will require. Finally, in examining receivables the investigator determines the practice of the concern regarding shipments on consignment or approval and attempts to discover any offset or contra accounts that may affect the collectible face of the assigned receivables. While these may not be important in most situations, occasionally a borrower sells merchandise to a company that supplies it with materials on a contra account basis.

The preliminary examination of an application also requires that receivables be verified to trade debtors. This is ordinarily accomplished through a subsidiary audit company, operated by the financing agency under a name and address that will not disclose the fact of assignment. A brief note is mailed to the debtor stating that an audit of the books of the creditor is being conducted and asking whether the account is a valid one, pointing out that the verification is not a request for

[12] Even though no funds are advanced against them, the lender may require that "unacceptable" accounts be assigned. Aside from adding some collateral value to the loan this has the important merit of simplifying the accounting procedures of both borrower and lender.

payment. The investigation may verify only the relatively large accounts and a random selection of others, but it is not unusual for every account to be verified at the time of the first examination.

Controlling an Active Loan

Once an application has been examined and approved and the client submits the first group of accounts for sale or assignment, there begins a continuous credit appraisal that does not cease until the arrangement is finally ended. This continuing credit appraisal has to do with two features of the client's affairs: first, the quality of the accounts assigned or sold and, second, the general status of the client's operations.

Each batch of submitted accounts is listed on a prepared "schedule of accounts." The schedule gives the date each invoice was created, its maturity date, its amount (gross and net) and the name and address or coding of the debtor. Finally, a column is provided for entering credit ratings for each individual debtor. At the same time that the schedule is being rated, the lending agency may initiate verifications of a sample of the invoices or accounts. Some financing agencies prefer to make sample verifications at frequent intervals rather than at the time a schedule of accounts is received (for example, a verification every 30 days of a certain percentage of the accounts held as collateral on outstanding loan balances).

Some financing agencies require that evidences of shipment be presented along with the assigned invoices. The financing agency examines the shipping documents and may actually verify them for a new client. Evidences of shipment are not required when the lender takes an assignment of a debtor's total account rather than of individual invoices, as is frequently the case in commercial bank practice.

Individual accounts are posted on ledger cards prepared for each trade debtor and grouped under the name of the client assigning them. These cards give the name and address of the debtor, his credit rating, and list all invoices purchased

and remittances received, together with all credits and allowances. Also, the card provides a record of verifications and shows delinquency, if any. Posting to the trade debtor's card reveals the present status of that account as regards the net value of collateral held and shows any special controls that have been established for the account. For example, as a credit standard the financing agency may set a maximum credit on certain accounts or may require that the account have no more than one invoice outstanding at a time. If there is a delinquency condition this will be disclosed in the posting, providing information that would not be revealed in even the most recent mercantile credit report. On the basis of this careful checking, which must be repeated every time the client submits a schedule of accounts, the financing agency decides what accounts are to be purchased from any particular schedule.

Periodic checks are made of all assigned accounts in order to keep current the classification of accounts by delinquencies. The principal means for checking this aspect of a client's account is the field audit. Every thirty days, or at some other interval determined by the financing agency's judgment as to the status of the account, an auditor makes a surprise examination of the client's records. This means, primarily, that the examiner must compare his ledger account for each trade customer with the ledger maintained by the client. This comparison may reveal credit allowances, contra items or unreported receipts. Where discrepancies do arise the auditor notes them in his report and tries to obtain not only an adequate explanation, but some correction of the situation. At this time the auditor also examines the cash book and journal entries to determine whether remittances have been diverted, or credits allowed, that do not appear on the ledger sheets. At these 30-day intervals all receivables and accounts and notes payable may be aged and compared with those shown in previous audits.

An essential function of the regular audit is to see that the receivables are properly stamped or designated in the client's office records as having been sold or assigned, and that all

recordations of assignments have been made where necessary. Frequently, all or part of the client's accounts are verified at the time of the audit rather than at the time accounts are purchased or taken under assignment. If the client is obtaining funds on inventory, as well as on receivables, the periodic audit affords an opportunity for an examination of the value and condition of this collateral. Finally, the audit may include an examination of the principal current assets and liabilities of the client, of returns and allowances related to sales, and a listing of accounts that seem large—for example, those that constitute more than 10 percent of the total credit line established for the client or are otherwise deserving of special mention.

The examination of the schedules of accounts as received and the surprise audits provide a running or continuing control over collateral security. In addition, these controls keep the financing agency continuously informed as to the client's business habits and financial condition. In order to systematize and simplify the use of such information, some companies maintain rather elaborate records on each client. First, there is a credit file on each client containing all financial statements, copies of auditor's reports, and all memoranda and correspondence dealing with the account. Second, a control sheet is maintained on which daily entries are made showing (a) amount of collateral held, (b) client's debit balance, (c) client's reserve, (d) daily totals of assignments accepted, (e) daily totals of cash advances, (f) daily totals of remittances received, (g) daily totals of returns, credits, and contra or offset items, (h) cash payments to the client out of equity, (i) totals of delinquent accounts repurchased or taken up by the client. These daily totals are then cumulated and a monthly report prepared.

Third, a special record may be prepared for each client showing the monthly reports. From this it is possible to compute ratios of returns to sales, ratios of cash and trade discounts taken by customers to sales, ratios of delinquent accounts repurchased to total accounts assigned, etc. On the

basis of these records the credit officer can detect trends that may require a decrease or permit an increase in the percentage advanced on accounts, and may discover other changes in the client's financial position that are important to an understanding of the underlying credit situation.

Credit Analysis and Standards of Commercial Banks

The operating methods and practices of commercial banks in accounts receivable financing are sometimes patterned closely after those of commercial finance companies. Some banks have employed credit officers with finance company experience to organize and operate their receivables loan departments. It will not be necessary to describe the operating policies of such banks beyond saying that the foregoing description of finance company practice is also broadly applicable to them. However, not many banks have a volume of receivables financing which they consider sufficiently large to warrant their adopting methods similar to those of the commercial finance company; other banks feel that a shorter method of appraisal is sufficient on the ground that the quality of their borrowers justifies the exercise of somewhat less in the way of precautionary measures. Still another group of banks is composed of those that have made a more determined effort to obtain a substantial volume of this type of business and, while they have developed more formalized and routine methods of operation, have attempted to cut the operating details to a minimum in the interests of simplicity and economy. In the following discussion we shall limit ourselves to a description of the latter and to the main points of difference between their operating procedures and those of commercial finance companies.

With regard to the appraisal of the general financial risk in receivables financing, there is little difference between the practices of commercial finance companies and commercial banks. Commercial banks are somewhat more inclined, perhaps, to lay principal emphasis on the general financial position of the applicant rather than on the collateral security

offered. With the bank credit officer, as with others, the moral hazard presented by the applicant is of primary importance and considerable care is taken to investigate this aspect of the applicant's record.

It is in the appraisal of the collateral security and in the continuing supervision of the loan account that we find the most marked differences between agencies. Some banks appraise their accounts and supervise individual assignments of accounts in just the same manner as that described above for commercial finance companies; at the other extreme, some banks simply study the general paying record of the applicant's customers and select the better accounts for assignment; loans continue to be made on these accounts so long as subsequent developments are reasonably favorable. Between these two extremes are other methods that are of interest because they incorporate many of the features of the more complete method but eliminate certain of its detailed operations.

A general feature of these shorter operating techniques is that the bank takes an assignment of all or a certain block of the borrower's accounts receivable rather than of a list of selected accounts. Where all of the receivables are assigned, a technique may be used which eliminates appraisals of accounts every time an assignment is made. This is done by determining, at intervals generally not greater than two months, what proportion of the borrower's total accounts are acceptable as loan security and what percentage is to be advanced on acceptable collateral. Once these proportions have been set, they can be applied to the borrower's accounts when assigned, until another appraisal is made. One such method is to express the amount of the unacceptable accounts of the borrower as a dollar amount, say $10,000 out of a total of $60,000. If the bank decides, on the basis of its investigation, that it will make an 80 percent advance on acceptable receivables, the borrower's receivables will have a maximum loan value of $40,000. This loan value is established at the time of the initial appraisal of the client and revised subsequently, at bi-monthly intervals or more frequently, if the facts warrant

it. In the interval, the established ratios are applied to each assignment as made.

Another method takes special account of the size of the accounts receivable in deciding which are acceptable. While this method can be used where all receivables are assigned it is especially suitable for the assignment of blocks of accounts. Obviously, in these cases the block of receivables assigned is not composed of selected accounts but is a certain section of the borrower's ledger, for example, all accounts numbered 1 to 100. All accounts below a certain amount, depending on the character of the client's business, are considered acceptable at their full face amount (unless seriously delinquent) regardless of the general credit rating of the trade customer. Accounts of larger amount, particularly those over $1,000, are given special attention. Each of these accounts is listed and the maximum trade credit extended to the trade customer determined by an examination of records going back over several years. This maximum is referred to as a "high credit" and is compared with the trade debtor's net worth; the amount of the credit considered acceptable is limited to the high credit or to 10 percent of the trade debtor's net worth, whichever is smaller. This comparison of acceptable to high credits may be made for all accounts over a certain size having a "high" or "good" mercantile credit rating; the full amount of accounts of this size representing sales to concerns with only "fair" or "limited" credit rating may be considered unacceptable. After these calculations have been made, summations of acceptable credits and high credits are made and the proportion of one to the other determined. The ratio so derived, say 80 percent, can then be applied to each subsequent assignment of a block of receivables to determine their gross loan value. The net loan value is set by deducting an additional percentage determined on the basis of studies of returns, allowances, trade and cash discounts, normal bad debt losses and profit margins. This same method is sometimes followed with the difference that in determining the ratio of acceptable to total receivables principal emphasis is placed on the paying record of trade debtors.

That is, all current accounts may be considered acceptable and varying proportions of past due accounts, depending primarily on the extent of their delinquency. In any case these ratios can be adjusted when further general appraisals are made of the client's business.

There are other ways in which detail is reduced in taking an assignment of all, or of a certain block, of the client's accounts rather than of a specific listing of accounts. The effect of this procedure is to reduce considerably the amount of record keeping performed in the banking office. Where all accounts are taken, there is no question about which remittances are to be sent to the bank and the bank does not keep separate ledger cards for each of the trade debtors whose accounts payable it has acquired as collateral for the loan balance. The full amount of the flow of collections is applied directly to the loan balance or placed in a collateral deposit account. Obviously, if the loan equals only a small part of the total receivables outstanding (because the borrower had use for only this amount but gave an assignment of the full amount of his receivables) then the loan is paid out in a period much shorter than the average maturity of accounts. However, it is usually the case that the borrower is receiving the full loan value of all his accounts under this plan. The bank may keep credit cards for the principal trade debtors of its borrower, but this is for credit references and not for a continuous posting of assignments, remittances, etc. During the period between audits, any remittances from the client that seem large in relation to what the bank considers a reasonable amount of trade credit for the debtor in question are checked against these cards. Another method of reducing the amount of record keeping done in the bank is to use a custodian in the office of the client to see that remittances on assigned accounts are turned over to the bank as received and to perform other duties in supervising the client's account.

A third feature of some of these shorter methods is that they generally provide that the borrower have only one note

outstanding at a time. When the client wishes to make a new assignment to acquire additional funds, another assignment is taken of all, or of a certain block, of the client's accounts. The loan value of the assigned accounts is determined and a new note is prepared for the unpaid balance on the old note and the amount of new funds advanced. This reduces greatly the amount of detail involved where the bank holds more than one note and has to match remittances with the particular note secured by the account on which the remittance has been received.

Other Risk-Limiting Procedures

Aside from appraisals of the client and the collateral security, there are other procedures that are adopted by the financing agency to limit its risk exposure and to assure itself of some stability even in the face of losses. First, the financing agency may strive for a diversification of risks, second, it may establish special reserves against losses on its receivables financing. With regard to diversification there are wide differences among the different types of financing agencies. Commercial banks seem to have paid little attention to diversification of receivables loans, doubtless because they represent only a very small part of the total loan portfolio. This is not the case with the commercial finance companies; their diversification consists partly in a wide range of types of clients and in a combination of accounts receivable financing with the extension of credit on the security of instalment contracts arising out of sales of consumer and income-producing equipment and other types of assets.

Some evidence is available to show the amount and kind of reserves held by factors against assets acquired in the course of business. However, the practices of factoring companies in preparing financial statements vary so widely that it is not possible to consolidate enough separate statements to cover any appreciable share of the total business. In general, the factoring companies hold separate reserves designated as "reserves for losses and contingencies" and "reserves for discounts"

and, in some cases, a special reserve against losses on merchandise advances. In addition, the factoring company carries a liability item called "balances due to clients," although this is not properly viewed as a reserve account. These credit balances represent the proceeds of purchased receivables that have not been withdrawn by the clients. As has been indicated above, the factor customarily requires that the client maintain a credit balance to take account of merchandise returns, customer allowances, etc., that arise on purchased receivables but usually the amount held in the credit balance is much more than would be necessary to meet this requirement, the excess representing funds that the client has not wished to withdraw.

Data on the two factoring companies reporting these items in detail are given in Table 15 showing that reserves for losses and contingencies were at a low of .9 percent of notes and accounts receivable held at the end of 1937 and at a high of 1.4 percent at the end of 1938 and 1939. It is understood that 2 percent of outstandings, or less, is considered the general practice with respect to reserves. Separate reserves, of course, are held against merchandise advances and these may vary quite widely. In 1938 the reserve for discount was the same as the reserve for losses, in the other years slightly greater. However, this is not a loss reserve but rather an account set up to absorb the reduction in the gross face value of receivables for discounts allowable to customers according to terms of sale. Other data not presented here show that the relation of reserves for losses and contingencies and reserves for discounts to accounts receivable held by factoring companies have remained substantially stable since 1930 and that all concerns for which data are available followed approximately the same practice with respect to these reserves.

It will be noted that the credit balances of clients were quite substantial over the period studied. From 1937 to 1941, inclusive, these varied from 24 to 31 percent of outstanding receivables for the two factoring companies covered, indicating the considerable extent to which factors' clients fail to

Table 15—Reserves for Losses, Amounts Due to Manufacturers and Others, and Reserves for Discount of Two Factoring Companies, in Percent of Receivables Held on December 31, 1937-41 [a]

Year	Accounts and Notes Receivable	Reserve for Losses and Contingencies		Due to Manufacturers and Other Clients [b]		Reserve for Discount	
		Amount	In Percent of Receivables	Amount	In Percent of Receivables	Amount	In Percent of Receivables
1941	$22,025,760	$220,000	1.0%	$6,843,778	31.1%	$267,921	1.2%
1940	16,649,338	205,078	1.2	4,584,012	27.5	249,569	1.5
1939	17,212,455	232,542	1.4	4,413,443	25.6	250,844	1.5
1938	18,273,218	262,026	1.4	5,354,195	29.3	260,454	1.4
1937	16,480,160	146,724	.9	4,000,695	24.3	218,628	1.3

[a] Data obtained from 10K statements submitted to the Securities and Exchange Commission, and from the National Credit Office, Inc.

[b] Includes credit balances of clients.

withdraw the full amount of their proceeds from sales of accounts.

The loss reserve practice of commercial finance companies is more difficult to state because of the diversified financing in which they engage. The fact that they, like commercial banks, advance only a certain percentage of the estimated collectible face value of the accounts purchased, usually 70 to 80 percent, provides a margin of collateral but this is not a reserve in the strict sense. It has been shown in Chapter 3 that the "reserve for losses" set up by these companies, plus clients' equities, varied at the end of 1941, for six different companies, from 9 percent to 25 percent of total assets. Commercial banks, on the other hand, make such small amounts of these loans that they depend on their general reserves for losses and contingencies to absorb losses arising from their accounts receivable loans.

7

Client Charges, Operating Expenses and Profits

TWO CONSIDERATIONS ARE IMPORTANT to the analysis of levels of charges in accounts receivable financing. First, in some instances the client receives a number of services in addition to the advance of funds. Consequently, not all the charges paid by clients are to be interpreted exclusively as costs of funds. Second, there is a substantial area in receivables financing in which the risks undertaken are greater, on the average, and the costs of selecting or limiting risks are higher, than in many other types of financing relationships. Risk conditions are reflected in both gross income and gross expenses of receivables financing. These conditions act, in some cases, virtually to invalidate comparisons of the charges levied under different financing arrangements; in the subsequent sections, therefore, the practices of the principal types of receivables financing agencies are examined separately.

Client Charges

Factors

Factoring companies customarily quote charges to clients in two parts, as a commission on the net amount of receivables purchased and as a per annum rate of interest at which receivables are to be discounted. Data on the relative importance of these two charges, as sources of income for the factoring company, are available on only one company in recent years. It is believed, however, that this company is fairly representative. Results of a study of its income statements are given in Table 16. This table shows that, of the two charges, the commission is the major source of income, comprising 59 to 70 percent of gross income earned. The remainder is earned as

Table 16—Gross Income and Percentage Distribution by Source of Income for Two Commercial Finance Companies and One Factoring Company, 1933-40 [a]

Year	Two commercial finance companies				One factoring company			
	Gross Income	Percentage Distribution by Source of Income			Gross Income	Percentage Distribution by Source of Income		
		Service Charges [b]	Interest and Commissions	Other Revenue		Interest	Commissions	Other Revenue
1940	$2,267,734	94.4%	4.7%	.9%	$1,468,257	35.2%	64.8%	[c]
1939	1,944,745	94.3	5.0	.7	1,882,775	29.7	69.8	.5%
1938	1,893,985	94.5	4.5	1.0	2,004,575	33.3	66.7	[c]
1937	1,882,111	95.0	3.9	1.2	2,078,044	41.2	58.7	.1
1936	1,500,473	94.7	3.5	1.8	1,707,774	39.6	60.3	.1
1935	1,286,070	91.4	5.2	3.4	1,354,602	34.4	64.8	.8
1934	964,001	88.3	6.8	4.9	1,118,896	31.7	68.0	.3
1933	809,434	88.7	7.3	4.0	1,036,628	29.9	68.3	1.8

[a] Data taken from reports to the Securities and Exchange Commission.

[b] This distribution of income by source reflects present methods of quoting charges as a "service charge" of some fraction of 1 percent per diem. Other finance companies quote a per annum "interest rate" on average daily balances plus a service charge on volume; for such companies the item "service charges" would be less important than in this table.

[c] Less than .05 percent.

interest on cash supplied under purchases of receivables and on loans secured by clients' merchandise inventories. A very small amount (less than 1 percent of gross income in every year except 1933) came from other sources, such as investments.

As to the level of factoring charges, receivables are discounted by factoring companies at the present time at a per annum rate of 6 percent, although in some cases the rate may be 5 percent. In this respect factoring charges have remained unchanged for a considerable period of time. On the other hand, it is maintained that, in recent years, competition has tended to reduce the factor's commission rate. There is, however, very little factual evidence available on this point. Only one factoring company has reported a breakdown of income that makes it possible to compute ratios of commissions earned to the gross amount of receivables purchased by years; the range of variation over the period 1933-40 is from a low of 1.2 to a high of 1.6. It is generally understood that, at the present time, commissions vary for different customers from .75 to 2 percent of sales cashed. While the data in Table 16 are obviously inadequate to reveal any trend that may have developed in the level of factoring commission rates, other evidence tends to support the statement that commission rates are not likely to exceed 2 percent of sales cashed and may be as low as .75 percent for some accounts. The rate charged any particular client is governed mainly by competition, the volume of sales to be handled and the quality and average size of the receivables to be purchased.

Finally, it should be noted that the two charges levied in connection with factoring are related to two different factoring functions. First, the factor's commission is charged for the service of selecting and collecting credits and assuming the credit risk on the receivables purchased. This is generally, although not necessarily, accompanied by a requisition on the part of the client for a supply of funds prior to the maturity of the receivables. Where cash is thus supplied, this is paid for by a charge calculated by computing the average

due date plus 10 days for the receivables purchased and discounting the receivables, as indicated above, at a rate of 6 percent per annum. Clients are credited at the same rate for credit balances left with the factor although if these balances are very large, reflecting little need on the part of the client for the factor's funds, the interest paid may be adjusted downward.

Commercial Finance Companies

The sources of income of commercial finance companies are necessarily less uniform than those of factoring companies because of the greater diversity of their business. This is illustrated in Table 17 which shows the operating income of one commercial finance company, by type of business. It is to be noticed that there is no interest income on open accounts receivable purchased; income on advances is classified as a service charge. Data on the company covered in Table 17 and on another, a large national commercial finance company, were combined to produce the results in Table 16 showing that service charges alone have amounted to from 88 to 95 percent of gross income, with commissions and other non-interest revenues accounting for an undeterminable proportion of the remainder.

These data are a direct reflection of the character of commercial finance company charges. These charges are normally computed as a certain percent per day of the total gross amount of the client's receivables held by the financing agency. This rate varies for different clients, depending on somewhat the same considerations as in the case of the factor's commission charge. One of the chief considerations is the amount of work involved in handling a particular client's receivables. At present, rates vary from 1/50 of 1 percent to 1/25 of 1 percent per day with a substantial portion set at 1/40 of 1 percent. Since the amount of the lender's funds actually in use in the client's enterprise is less than the gross amount of the receivables held by the finance company, by an amount depending on the percentage of receivables retained

Table 17—OPERATING INCOME OF ONE COMMERCIAL FINANCE COMPANY, 1934, BY TYPE OF BUSINESS [a]

Source of Operating Income	*Accounts Receivable*	*Secured and Unsecured Notes Receivable*	*Industrial Liens*	*Instalment Liens*	*Total*	
					Amount	Percent
Service charges	$263,915	..	$87,963	$1,882	$353,760	82.9%
Bonds [b]	20,383	..	..	..	20,383	4.8
Interest	..	$20,659	..	..	20,650	4.8
Discount and commissions	..	13,539	..	..	13,539	3.2
Collection fees, etc.	..	..	987	..	987	.2
Recoveries of accounts previously written off	3,572	11,579	..	2,491	17,642	4.1
TOTAL	$287,870	$45,768	$88,950	$4,373	$426,961	100.0%

[a] Data taken from reports to the Securities and Exchange Commission.
[b] Premiums paid by clients for fidelity and fraud bonds.

as a collateral margin, these rates understate the annual effective rate to the client where charges are based on the face amount of collateral held by the finance company.[1] Assuming a 75 percent advance, the range of rates cited above produces effective rates of from 9.7 to 19.5 percent per annum; assuming a 90 percent advance, the range of rates works out to 8.1 to 16.2 percent per annum on funds in use. A rate of 1/40 of 1 percent per day produces an effective rate of 12.2 percent per annum on a 75 percent advance and a rate of 8.1 percent per annum on a 90 percent advance.

Since it is likely that the clients with the smallest percentage advances will also carry the highest financing charge, and that the best clients will get both a large percentage advance and a lower rate, it is likely that the actual range of rates is from approximately 9 percent per annum on money in use for the best clients to 20 percent per annum for those whose accounts present the financing agency with the heaviest operating costs and whose receivables are of a quality to command only a relatively low percentage advance. In point of fact this rate, considered as a cost of acquiring a financing service, may be higher if the client is required to pay the premiums of fidelity and fraud bonds as a condition of receiving the service. Clearly, the cost of providing this protection must necessarily be heaviest for the highest risks. While it is obvious that these charges raise the cost of the financing service for certain clients, there is no factual evidence available as to the extent of this increase.

In addition to the rate form discussed above, the commercial finance company may levy a delinquency charge but this is usually found where a rate, say 6 percent per annum, is levied on cash advanced plus a service charge on receivables acquired. Apparently, however, this is infrequently used as a form of quoting customer charges.[2]

Since no data are available to show a breakdown of com-

[1] One form of rate competition is to base the per diem interest charge on the amount actually advanced rather than on the face amount of collateral held. It is not known how general this procedure is.

[2] See *Problems of Small Business*, TNEC Monograph No. 17, pp. 347-53.

mercial finance company income by type of business it is not possible to provide a statistical measurement of charges. The only tests that are possible are computations showing the relations of total operating income of commercial finance companies to total receivables acquired. Changes in this ratio are obviously affected by changes in the distribution of volume acquired from the different types of receivables. Furthermore, since these companies hold substantial amounts of receivables having maturities of 12 months and over, changes in the annual volume of receivables acquired produce very substantial changes in the ratios of income earned to annual volume of receivables purchased. These changes are wholly unreliable as indications of changes in the level of charges on any particular type of receivables acquired.

Commercial Banks

The widely varying practices of commercial banks in quoting charges make it difficult to give a general statement of the cost of acquiring funds from them through the assignment of open accounts receivable. In general, however, commercial banks can be classified into two groups with respect to their methods of quoting charges on such loans. First, many banks charge a per annum interest rate on the outstanding debit balance arising out of loans secured by assigned receivables without any additional service charge. Second, other banks combine a per annum interest rate on average balances with some form of service charge or fee.

In general, the interest rates on average loan balances are 5 or 6 percent per annum, most frequently the latter, but several rates of 4 percent were reported in the course of this study. However, in order to express these rates in terms of effective per annum rates on money in use by the borrower, it is necessary to take account of the procedure followed in applying collections to loan balances. Where credits are made to the borrower's loan balance on the same day that collections are received and where the rate is charged against an average of the daily balances outstanding (that is, on a strict

"money in use" basis), the quoted rate is identical with the effective rate. However, the bank may apply collections to the borrower's loan balance only at stipulated intervals, say every week or every 30 or 60 days. Clearly, this procedure makes for a higher effective per annum rate on money in use than does the method of immediate application.

The effect of these two procedures cannot be determined without knowing the experience of banks with the timing of collections. If collections are received most heavily at or near the time when they are to be applied to the loan balance (as may well be the case if the loan balance is adjusted every 30 days and if the receivables have an average maturity of about 30 days), the effective rate would be only slightly higher than the quoted rate. On the other hand, if collections are received at a constant rate and are sufficient to pay the loan balance out entirely when the date arrives for them to be applied to the loan, then the effective rate calculated on a "money in use" basis is approximately twice the quoted rate.

On the basis of the present study's findings with respect to the average life of assigned receivables, and in view of the bank practice of usually writing the collateral notes arising out of these loans with a term matching the anticipated maturity of the receivables serving as collateral, we may conclude that the effective rate on money in use under these customer charges would not generally be more than one-third in excess of the quoted rates. It seems reasonable, therefore, to estimate that on a quoted interest rate of 5 or 6 percent per annum on average balances the annual effective rate would be not over 8 percent and possibly less.

In order, however, to compute total borrower cost in receivables financing it is necessary to take account of service charges. Nearly every commercial bank that was found in the present study to be making a substantial effort to increase its accounts receivable lending business charged a rate of interest on average loan balances plus a service charge. Some of the bases on which service charges were calculated include the following:

1. A certain percentage of the face amount of receivables accepted as collateral (e.g., ½ to 2 percent on the face of receivables acquired)
2. A certain sum per account or invoice assigned (e.g., 20 cents per account or 10 cents per invoice)
3. A certain sum per posting operation (e. g., 5 cents, including original listing, final collection and partial payments, or credits arising out of merchandise returns, etc.) or a certain rate on outstanding balances (e.g., ½ percent per month), whichever is higher
4. A fixed sum on the average loan balance, payable monthly (e.g., $1 or $2 per $1,000 of average loan balance)
5. A variable rate charged on collateral acquired (e.g., 1 percent of all collateral acquired in units of $50 or more, 1½ percent on all other units)
6. A certain fee for each audit, calculated to cover costs [3]
7. A certain rate chargeable on the amount of the note (e.g., 1½ percent per annum on the outstanding balance).

Finally, the basic per annum interest rate plus the service charge may be combined in a graduated rate, which, while charged on balances, is based on the volume of receivables acquired (for example, 12 percent per annum on balances up to $15,000 and 9 percent per annum on that part of the balance in excess of this amount).

Summarizing, the level of charges in accounts receivable financing, expressed in annual effective rates on money in use, varies all the way from a low of 5 or 6 percent for certain receivables loans of commercial banks to a high of 20 percent (exclusive of bonding expense, delinquency charges, etc.) for certain of the clients of commercial finance companies. In gen-

[3] The amount of the audit fee is not known but one bank stated that a 6 percent charge on the outstanding loan balance plus an audit fee averaged out to a 7 percent per annum effective rate.

eral, these differentials represent differences in (a) the character and extent of the financing service being supplied to the client or borrower, (b) the risk involved in the loan, and (c) the expense incurred by the financing agency in handling the clients' accounts.

Costs of Operation

The relative importance of different expense items for one factoring company and one commercial finance company is shown in Tables 18 and 19, respectively. Salaries, write-offs, additional provisions for losses, and interest on borrowed funds are the most important expense items. Table 18 shows that salaries tend to be somewhat inflexible as an expense item and that write-offs on customer accounts and additional provisions for such losses are not only high, relative to total expenses, but that changes in these accounts are primarily responsible for the operating profit or loss. It is interesting also that the relative importance of the interest expense on borrowed funds has tended to decline over the period 1933-41 for the factoring company studied. Expressed in terms of gross income, interest expense was 10 percent in 1933 and about 5 percent in both 1940 and 1941. That this represented mainly an ability to borrow funds on more favorable rates is borne out by the fact that the ratio of notes payable to total assets was 36 percent for this company in 1934 and 35 percent in 1940. It was somewhat higher in 1941, reflecting increased borrowings to finance a sharp increase in the volume of sales factored. Information on another factoring company, not presented here, shows that interest expense on borrowed funds fell from 23 percent of gross income in 1926 to 11 percent in 1932. This decline, however, seems to have been due in large part to an increased dependence on equity funds.

It is clear from these data that, even in years when the ratio of total expense to gross income has been relatively low, net write-offs on customer accounts and additions to loss reserves are highly significant expense items. This is true despite the fact that the ratio of losses to receivables acquired is remarkably small. For example, one of the largest factoring com-

Table 18—Percentage Distribution of Total Expenses of One Factoring Company, 1933-41, by Type of Expense [a]

Expense Item	*1941*	*1940*	*1939*	*1938*	*1937*	*1936*	*1935*	*1934*	*1933*
Salaries [b]	..	..	30.1%	19.9%	31.5%	40.7%	42.6%	39.5%	28.1%
Rent [c]	..	..	..	1.5	1.7	1.8	2.8	2.9	1.9
Taxes (other than income)	3.0%	3.0%	3.6	3.6	4.1	3.0	1.1	2.6	.9
Write-offs (net) [d]	28.1	21.1	21.0	16.1	18.1	7.8	11.2	5.1	11.0
Additions to loss reserve	..	..	..	31.6	12.9	12.3	8.6	14.5	26.4
Interest on borrowed funds	9.1	6.9	6.3	4.6	9.5	11.2	9.4	10.4	13.0
Other expenses	59.8	68.7	39.0	22.7	22.2	23.2	24.3	25.0	18.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total expense (000)	$1,142	$1,028	$1,630	$2,343	$1,539	$963	$795	$729	$809
Total expense in percent of gross income	61.3%	70.0%	86.6%	116.9%	74.1%	56.4%	58.7%	65.1%	78.1%

[a] Based on a report to the Securities and Exchange Commission.
[b] Salaries are included in "other expenses" after 1939.
[c] Rent is included in "other expenses" after 1938.
[d] Includes all provisions for losses, 1939-41.

panies has reported that net losses on factored receivables acquired from January 1 to September 30, 1936 was .242 percent. Further, a recent study stated that the losses of a medium-sized finance company acquiring open accounts receivable on a non-notification basis had amounted to less than .05 percent of total receivables acquired.[4] The meaning of the latter figure is different from that of the loss ratios for factors since it refers to paper acquired on a recourse basis and the losses it represents arise out of fraud or the failure of clients. Since commercial banks also acquire receivables on a recourse basis, their loss ratios should be comparable to those of commercial finance companies. Only a very small number of all banks interviewed had suffered any losses at all and invariably these were attributed to fraudulent acts on the part of the client, such as the assignment of fictitious receivables, duplicate assignments, the diversion of collections or failure to account for merchandise returns.

Barring contingencies such as the above, and granted a sound lien on the assigned receivables, the important question is the collectability of the receivables. This is best shown by data on the loss experience of factoring companies. Few companies report these figures, but one large factoring company reported net losses on customer accounts of .2, .5, .3 and .3 percent of volume acquired in 1926, 1930, 1931 and 1932, respectively. Another company, reporting for each year from 1934 to 1940, had net losses varying from lows of .1 percent in three different years, 1934-36, to a high of .5 percent in 1938. Very scattered information is available on other companies; what there is confirms the results cited above.

The cost structure of the commercial finance company shown in Table 19 is basically similar to that of the factoring company discussed earlier, with the exception of the item representing expenses incurred in promoting new business. Since this company is relatively new, the item is doubtless larger than it would be for a company of longer standing, but in part its size probably reflects a real operating difference

[4] TNEC Monograph No. 17, *op. cit.*, p. 348.

Table 19—EXPENSE ITEMS OF ONE COMMERCIAL FINANCE COMPANY, SEPTEMBER 2, 1937 TO DECEMBER 31, 1938, IN PERCENT OF TOTAL EXPENSE AND IN PERCENT OF GROSS INCOME [a]

Expense Item	*In Percent of Total Expense*	*In Percent of Gross Income*
Operating Expense	*70.3%*	*41.6%*
Salaries	35.6	21.1
Commissions	5.9	3.5
New business	11.7	6.9
Credit agency fees	3.2	1.9
Legal and accounting	2.2	1.3
Rent	1.6	.9
Printing and stationery	3.7	2.2
Telephone and telegraph	1.6	.9
Other operating expense	4.9	2.9
Other Expense	*29.7*	*17.5*
Taxes (other than income)	2.9	1.7
Provision for losses	11.0	6.5
Provision for depreciation	.7	.4
Interest on borrowings	15.1	8.9
TOTAL	100.0%	59.1%
	$121,413	$205,089

[a] Based on a report to the Securities and Exchange Commission.

between the factor and the commercial finance company.

Additional information on the cost structure of commercial finance companies is given in Table 20. This table is based on income and expense statements of three companies that do open accounts financing along with other financing, such as the purchasing of instalment sales contracts arising out of the sale of consumer durable goods and income-producing equipment. For these companies, interest expense on borrowed funds has declined from 29 percent of total expenses in 1932 to 14 percent in 1940. However, there has been no marked decline in the relative importance of charge-offs or of general operating expenses.

The only information available on the cost of handling open accounts receivable in terms of the volume of business transacted covers the operations of two factoring companies. A factoring company reporting for the years 1934 to 1940

Table 20—PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF THREE COMMERCIAL FINANCE COMPANIES, 1932-40, BY TYPE OF EXPENSE [a]

Expense Item	*1940*	*1938*	*1936*	*1934*	*1932*
Operating expenses	48.1%	47.1%	39.9%	49.8%	47.9%
Depreciation	1.0	1.1	.9	.3	.8
Taxes (other than income)	2.7	3.2	1.6	1.9	.9
Rents	1.9	2.2	1.9	3.1	4.4
Reserve for doubtful accounts	13.3	9.4	12.8	12.3	16.1
Other reserves	11.7	11.8	12.9	2.9	.5
Interest and discount	14.1	16.6	13.7	26.4	29.4
Other expenses	7.2	8.6	16.3	3.3	..
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%
Total expense (000)	$2,459	$1,973	$1,627	$419	$517
Total expense in percent of gross income	68.1%	68.1%	70.1%	66.4%	84.7%

[a] Based on reports to the Securities and Exchange Commission and reports to stockholders.

incurred total expenses varying from 1.2 to 2.8 percent of receivables acquired. In the year of the highest ratio, 1938, it had a net operating loss equal to .4 percent of receivables acquired. Another large factor for which information is available for an earlier period shows ratios of total expense to receivables acquired of 3.6, 2.6, 2.5 and 3.4 percent during the years 1926, 1930, 1931 and 1932, respectively.

Comparable estimates of the ratios of total expense to receivables acquired cannot be made for commercial finance companies since the expenses incurred in their receivables financing cannot be distinguished from expenses incurred in connection with other financing activities. To distinguish between these expenses would involve the same problems of cost allocation that are met in determining commercial bank costs in receivables financing.

One bank indicated that it had attempted to determine the costs of its accounts receivable loans by setting up an independent department to handle them and charging to the department all expenses except executive salary costs. This experiment demonstrated to the bank that a service fee of

2⅜ percent per annum, charged on average daily balances outstanding, about covered the special costs of handling accounts receivable loans. In addition the bank charged a basic interest rate on average daily balances of 5 or 6 percent per annum. Out of this interest income the department pays 3½ percent per annum on the funds in use in receivables financing into the general revenues of the bank and uses the remainder to set up a reserve against its own receivables lending operations.

Gross Income, Gross Expense and Net Profits

It has been shown that the gross income of factors and commercial finance companies is derived from a combination of commissions, service fees and interest charges, all of which must be taken account of in determining the cost of the service to clients. In general, but by no means invariably, these charges are higher than those commonly associated with short-term bank credit. It was pointed out, however, that in a large degree this is to be explained by reference to the nature of the services obtained by the borrower and the costs of administering these credits.

An analysis has been made of the profitability of the different types of receivables financing agencies, but information is available on so few companies that the results can be used only to support very general statements. One of the interesting results that comes from this analysis of the income and expense accounts of factors and commercial finance companies is that while their operating income is relatively high, as contrasted to a similar measure for commercial banking institutions, their operating expenses are likewise high. Thus, one factoring company had $10.64 gross income and $7.45 gross expenses for each $100 of total assets in 1940. It is the order of magnitude and general relation of these two figures that is important and not their exact amount, for it is not certain how representative this company is of factoring companies as a whole. A study of these same items for three of the larger commercial finance companies shows that gross

income was $9.90 per $100 of total assets for 1940, and gross expenses $5.90. Comparable figures for commercial banking operations are obviously quite different; these institutions carry a large percentage of their assets in cash or deposits to satisfy the legal requirements for reserve balances and the bank's own policy with respect to liquidity and have heavy investments in government obligations bearing low interest rates. It is to be expected, therefore, that income and expense totals, when related to total assets, will be lower than for other types of financing agencies. Thus, gross income was $2.98 per $100 of assets for all insured banks in 1940 and gross expenses were $2.37.

One general statement can be made, however, with respect to the net profitability of the various types of agencies. Taken as a whole, it appears that the ratio of net profit to net worth for factoring companies and commercial finance companies is both higher and more variable than is the comparable measure of profitability for commercial banks.

APPENDICES

A. Procedures Followed in Estimating Factoring Volume

B. Procedures Followed in Selecting Commercial Bank Sample

C. Supplementary Tables

A

Procedures Followed in Estimating Factoring Volume

THE ANNUAL VOLUME OF SALES factored for the period 1934-41, inclusive, is available for four of the major companies. Comparable data for James Talcott, Inc. are available in reports to the Securities and Exchange Commission for 1934-39, but it was necessary to estimate this company's 1940 and 1941 volume by applying to its outstandings at the end of these years the average of its ratios of year-end outstandings to annual volume from 1934 to 1939. Also, estimates had to be made of the annual volume for Textile Banking Company and Edmund Wright Ginsberg Corporation, the factoring subsidiaries of Commercial Credit Company, for certain years; the volume for Textile Banking Company was known for the period 1933-39 inclusive, but that of Edmund Wright Ginsberg, while known for 1932, had to be estimated for the period 1933-35 inclusive.

Estimates for Edmund Wright Ginsberg over the period 1933-35 were made on the assumption that annual changes in the volume of receivables purchased by this company were the same, in both direction and percentage amount, as those of Commercial Factors Corporation. Changes in the volume of receivables purchased by Commercial Factors Corporation over this period are known to be fairly representative of changes shown by other factoring companies.

Finally, it was necessary to estimate the volume of receivables purchased by both Textile Banking and Edmund Wright Ginsberg for the years 1940 and 1941. This was done by taking that portion of the total volume of "open accounts, notes and factoring receivables" acquired by Commercial Credit Company that was considered to represent the factoring component. As reported by Commercial Credit Company, total "open accounts, notes and factoring receivables" acquired combines the business transacted by its factoring subsidiaries, Textile Banking and Edmund Wright Ginsberg, with the company's non-notification receivables financing. The division of this total was known for 1939; the 1940 and 1941 estimates were made on the assumption that in those years the company's factoring bore the same relation to total open accounts receivable financing as in 1939.

These estimates probably err on the side of overstatement of volume,

particularly in 1940 and 1941. First, it is thought that the method used in computing the volume of receivables purchased by Commercial Credit Company subsidiaries overstates their actual volume but it is not known by how much. Second, some factoring companies purchase accounts on a non-notification basis and some of this may have been included as factoring. The extent of this error cannot be determined, because there is no information as to the relative importance of this type of financing beyond general statements that it is not done in significantly large amounts. Third, it is thought that with the emergence of war contract financing some part of the receivables held at the end of 1941 represented accounts having longer terms than customary in textile factoring. However, the estimates are understatements in the sense that they represent only the activity of factors in buying invoices or accounts receivable and do not display their importance as lenders through the making of advances to clients on merchandise or on other bases.

B

Procedures Followed in Selecting Commercial Bank Sample

IN AN EFFORT TO DETERMINE the extent of commercial bank activity in accounts receivable financing, questionnaires were sent to a random sample of approximately 800 institutions identified from the Federal Deposit Insurance Corporation list of 13,492 "insured commercial banks." In selecting the sample, all banks on the list were divided into five groups according to the population of the city in which the bank was located. Every 36th bank was selected from those located in centers of population of under 10,000; every 9th bank was selected from those in centers of population of from 10,000 to 50,000 and every 3rd bank was selected from among those in centers of population of 50,000 or over. In order to permit closer examination of results for the larger banks, questionnaires returned by banks in the last group were later subdivided into three groups: banks in centers of population of 50,000 to 100,000; 100,000 to 500,000; and 500,000 and over. This method of selection produced a sample of approximately 800 banks and these institutions returned 328 completed questionnaires. The following questions were asked on the questionnaire:

1. Do you at the present time *regularly* engage in extending credit to business concerns by purchasing or taking assignments of their open accounts receivable? ("Yes" or "No")

(*Important Note:* If you acquire receivables *only* as secondary collateral for loans made on other primary security, or only to secure loans previously made on an unsecured basis, answer "No.")

2. If you do regularly engage in open accounts receivable financing, state—

(a) The *total number of business concerns* that you are now financing in this way: .....

(b) The *number of these concerns engaged primarily in retail trade*: .....

3. If you do regularly engage in open accounts receivable financing, state—

(a) The *approximate total amount of your outstanding advances against open accounts receivable:* $..... as of ..... (a recent date)

(b) The *approximate amount of such advances to businesses engaged primarily in retail trade:* $.....as of ..... (same recent date)

C

Supplementary Tables

Table C-1—NUMBER OF BANKS REPORTING ON PARTICIPATION IN ACCOUNTS RECEIVABLE FINANCING, BY DEPOSIT SIZE OF BANK, SIZE OF POPULATION CENTER AND REGION IN WHICH BANK IS LOCATED [a]

	Number of Banks Replying		*Ratio of Participating to all Responding Banks*
	Yes	No	
Deposit Size of Bank [b]			
$1,000 or less	5	74	1 to 16
1,000–5,000	25	92	1 to 5
5,000–10,000	13	26	1 to 3
10,000–50,000	26	33	1 to 2
Over 50,000	19	13	1 to 2
ALL REPORTING BANKS	88	238	1 to 4
Size of Center of Population [c]			
Less than 10,000	9	78	1 to 10
10,000–50,000	13	56	1 to 5
50,000–100,000	11	30	1 to 4
100,000–500,000	28	49	1 to 3
500,000 and over	28	25	1 to 2
ALL REPORTING BANKS	89	238	1 to 4
Region			
New England	7	17	1 to 3
Middle Atlantic	29	44	1 to 3
East North Central	22	41	1 to 3
West North Central	6	50	1 to 9
South Atlantic	7	37	1 to 6
East South Central	7	13	1 to 3
West South Central	5	16	1 to 4
Mountain	2	10	1 to 6
Pacific	4	10	1 to 4
ALL REPORTING BANKS	89	238	1 to 4

[a] Based on a questionnaire survey.
[b] Total deposits in thousands of dollars. Each size class is exclusive of the lower limit and inclusive of the upper.
[c] Each size class is inclusive of the lower limit and exclusive of the upper.

Table C-2—ACCOUNTS RECEIVABLE LOAN BALANCES IN AMOUNT, AND IN PERCENT OF TOTAL LOANS AND DISCOUNTS, BY SIZE OF POPULATION CENTER AND REGION IN WHICH BANK IS LOCATED [a]

	Number of Banks	*Total Loans & Discounts*	*Accounts Receivable Loan Balances* Amount	In Percent of Total Loans & Discounts
Size of Center of Population [b]				
Under 10,000	9	$3,684,000	$105,251	2.9%
10,000–50,000	13	20,326,000	440,740	2.2
50,000–100,000	11	29,419,000	859,648	2.9
100,000–500,000	28	331,450,000	4,435,085	1.3
500,000 and over [c]	28	1,464,897,000	10,901,172	.7
Region				
New England	7	373,566,000	4,101,161	1.1
Middle Atlantic	29	960,906,000	6,779,102	.7
East North Central	22	198,406,000	2,309,657	1.2
West North Central	6	77,273,000	622,977	.8
South Atlantic	7	12,560,000	293,389	2.3
East South Central	7	91,065,000	830,784	.9
West South Central	5	51,449,000	637,822	1.2
Mountain	2	1,414,000	8,000	.6
Pacific	4	82,569,000	1,159,004	1.4
ALL REPORTING BANKS	89	$1,849,208,000	$16,704,396	.9%

[a] Based on a questionnaire survey.

[b] Each size class is inclusive of the lower limit and exclusive of the upper.

[c] Includes the following cities: Baltimore, Boston, Chicago, Cleveland, Detroit, Los Angeles, Milwaukee, New York, Philadelphia, Pittsburgh, St. Louis, San Francisco, and Washington, D. C.

Index

ACCOUNTS RECEIVABLE FINANCING—Growth of Interest in, 16; And Availability of Credit, 16; Definition of, 17; Importance in Commercial Banks, 55; As "Interim" Financing, 67; Profitability, 142-43.

ASSET STRUCTURE—Factors, 42; Commercial Finance Companies, 50.

BANK BORROWING—By Factors, 44; By Commercial Finance Companies, 52.

BANK EXAMINATION AND ACCOUNTS RECEIVABLE FINANCING—29-31.

CASH COLLATERAL ACCOUNT—83.

CHANDLER ACT—28-29.

CHAPMAN, JOHN M.—17n, 25n, 53n, 55n.

CLIENT CHARGES—Factors, 128-30; Commercial Finance Companies, 131-33; Commercial Banks, 134-37.

CLIENTS—Characteristics of in Factoring, 58-60; Characteristics of in Non-Notification Financing, 61.

COLLECTION EXPERIENCE—139-40.

COMMERCIAL BANKS—Growth of Interest in Accounts Receivable Financing, 25-31, 52; Frequency of Participation in Accounts Receivable Financing, 53-57; Classification of Clients, 76; Receivables Financing Organization in, 96. *See* Client Charges, Contract Provisions, Credit Analysis, Promotional Methods, Volume Estimator.

COMMERCIAL FINANCE COMPANIES—Non-Financial Services of, 89; Organization of, 94-96. *See* Asset Structure, Bank Borrowing, Client Charges, Contract Provisions, Net Worth, Promotional Methods, Volume Estimator.

COMMISSION HOUSES—19.

CONSOLIDATION MOVEMENT—40-41.

CONTRACT PERIOD—Factoring, 79-80; Non-Notification Financing, 81.

CONTRACT PROVISIONS—Factoring, 100-04; Commercial Finance Companies, 104-06; Commercial Banks, 107-09.

COSTS OF OPERATION—79, 138-42.

CREDIT ANALYSIS—Elements of in Factoring, 109-11; Commercial Bank Methods of, 120-24.

CREDIT BALANCES—45, 71, 85, 125.

CREDIT STANDARDS—Current Ratio and, 111.

FACTORING—Definition of, 17; Economic Function of, 18-20; Demand for Services of, 18-20; Styling and Merchandising Services in, 24-25; Concentration in New York City, 39-40; Outside Textiles, 60-61.

FACTORING COMPANIES—Organization of, 92-94.

FACTORS—Non-Financial Services of, 89. *See* Asset Structure, Bank Borrowing, Client Charges, Contract Provisions, Net Worth, Promotional Methods, Volume Estimator.

FOULKE, ROY A.—34n.

FRAUD—114-15.

JACOBY, NEIL H.—39n.

LEGAL BASIS OF RECEIVABLES FINANCING—25-31.

LOAN BALANCES—Size, 61; Relation to Net Worth, 68; Size in Factoring, 70; Size in Non-Notification Financing, 72; Control Over, 117-20.

LOSS RESERVES—Factoring, 45, 124-27, 142; Non-Notification Financing, 52.

MERCHANDISE ADVANCES—44, 45, 72.

MILLS, GEORGE—33n.

NET WORTH—Factors, 42-43; Commercial Finance Companies, 53.

NON-NOTIFICATION FINANCING—Definition of, 17; Business Demand for, 21-25; And Availability of Credit, 22-23; Legal Conditions Affecting, 25-31; Growth of, 47.

NON-NOTIFICATION PROCEDURE—Reasons for, 21-22.

PERCENTAGE ADVANCE—Amount of, 86; Elements Determining, 88.
PLUMMER, WILBUR C.—17n, 44n.
PROFITABILITY—In Accounts Receivable Financing, 142-43.
PROMOTIONAL METHODS—Factoring, 97; Commercial Finance Companies, 97-98; Commercial Banks, 98-100.

RECEIVABLES—Size of, 77-79; Turnover of, 72, 80, 81; Judging Quality of, 115-17.
RECEIVABLES LOANS—Size of, 78; Maturity of, 82.
RECEIVABLES TURNOVER AND CREDIT RISK—83.
RECOURSE ARRANGEMENTS—21, 84.

SAULNIER, RAYMOND J.—39n.
"SCHEDULE OF ACCOUNTS"—117.
SELIGMAN, E. R. A.—47n.

TRADE ACCEPTANCE—15.
TRADE DEBTORS—Balances of, 65.

VERIFICATION—116-17.
VOLUME ESTIMATES—Factoring, 33-34; Commercial Finance Companies, 35; Commercial Banks, 36-37.

WORK-OUT LOANS—18, 54.

YOUNG, RALPH A.—17n, 44n.

PUBLICATIONS OF THE NATIONAL BUREAU OF ECONOMIC RESEARCH

INCOME IN THE UNITED STATES
Wesley C. Mitchell, W. I. King, F. R. Macaulay and O. W. Knauth

*1 Volume I, SUMMARY (1921) — 152 pp.
*2 Volume II, DETAILS (1922) — 420 pp.
*3 DISTRIBUTION OF INCOME BY STATES IN 1919 (1922)
O. W. Knauth — 30 pp.
*4 BUSINESS CYCLES AND UNEMPLOYMENT (1923)
National Bureau Staff and Sixteen Collaborators — 405 pp.
*5 EMPLOYMENT, HOURS AND EARNINGS, UNITED STATES, 1920-22 (1923)
W. I. King — 147 pp.
6 THE GROWTH OF AMERICAN TRADE UNIONS, 1880-1923 (1924)
Leo Wolman — 170 pp., $2.50
*7 INCOME IN THE VARIOUS STATES: ITS SOURCES AND DISTRIBUTION, 1919, 1920, AND 1921 (1925)
Maurice Levin — 306 pp.
8 BUSINESS ANNALS (1926)
W. L. Thorpe, with an introductory chapter, "Business Cycles as Revealed by Business Annals," by *Wesley C. Mitchell* — 380 pp., $2.50
9 MIGRATION AND BUSINESS CYCLES (1926)
Harry Jerome — 256 pp., $2.50
10 BUSINESS CYCLES: THE PROBLEM AND ITS SETTING (1927)
Wesley C. Mitchell — 489 pp., $5.00
*11 THE BEHAVIOR OF PRICES (1927)
Frederick C. Mills — 598 pp.
12 TRENDS IN PHILANTHROPY (1928)
W. I. King — 78 pp., $1.00
*13 RECENT ECONOMIC CHANGES (1929)
National Bureau Staff and Fifteen Collaborators — 2 vols., 950 pp.
INTERNATIONAL MIGRATIONS
*14 Volume I, STATISTICS (1929), compiled by *Imre Ferenczi* of the International Labour Office, and edited by W. F. Willcox — 1,112 pp.
*18 Volume II, INTERPRETATIONS (1931), edited by W. F. Willcox — 715 pp.
*15 THE NATIONAL INCOME AND ITS PURCHASING POWER (1930)
W. I. King — 394 pp.
16 CORPORATION CONTRIBUTIONS TO ORGANIZED COMMUNITY WELFARE SERVICES (1930)
Pierce Williams and *F. E. Croxton* — 347 pp., $2.00
17 PLANNING AND CONTROL OF PUBLIC WORKS (1930)
Leo Wolman — 260 pp., $2.50
*19 THE SMOOTHING OF TIME SERIES (1931)
Frederick R. Macaulay — 172 pp.
*20 THE PURCHASE OF MEDICAL CARE THROUGH FIXED PERIODIC PAYMENT (1932)
Pierce Williams — 308 pp.
*21 ECONOMIC TENDENCIES IN THE UNITED STATES (1932)
Frederick C. Mills — 639 pp.
22 SEASONAL VARIATIONS IN INDUSTRY AND TRADE (1933)
Simon Kuznets — 455 pp., $4.00

* *Out of print.*

*23 PRODUCTION TRENDS IN THE UNITED STATES SINCE 1870 (1934)
A. F. Burns 363 pp.

24 STRATEGIC FACTORS IN BUSINESS CYCLES (1934)
J. Maurice Clark 238 pp., $1.50

25 GERMAN BUSINESS CYCLES, 1924-1933 (1934)
C. T. Schmidt 288 pp., $2.50

26 INDUSTRIAL PROFITS IN THE UNITED STATES (1934)
R. C. Epstein 678 pp., $5.00

27 MECHANIZATION IN INDUSTRY (1934)
Harry Jerome 484 pp., $3.50

*28 CORPORATE PROFITS AS SHOWN BY AUDIT REPORTS (1935)
W. A. Paton 151 pp.

29 PUBLIC WORKS IN PROSPERITY AND DEPRESSION (1935)
A. D. Gayer 460 pp., $3.00

30 EBB AND FLOW IN TRADE UNIONISM (1936)
Leo Wolman 251 pp., $2.50

31 PRICES IN RECESSION AND RECOVERY (1936)
Frederick C. Mills 561 pp., $4.00

32 NATIONAL INCOME AND CAPITAL FORMATION, 1919-1935 (1937)
Simon Kuznets 100 pp., 8¼×11¾, $1.50

33 SOME THEORETICAL PROBLEMS SUGGESTED BY THE MOVEMENTS OF INTEREST RATES, BOND YIELDS AND STOCK PRICES IN THE UNITED STATES SINCE 1856 (1938)
F. R. Macaulay 586 pp., $5.00
"The Social Sciences and the Unknown Future," a reprint of the introductory chapter to Dr. Macaulay's volume: 35 cents; in orders of 10 or more, 25 cents.

*34 COMMODITY FLOW AND CAPITAL FORMATION, Volume I (1938)
Simon Kuznets 500 pp., 8¼×11¾

*35 CAPITAL CONSUMPTION AND ADJUSTMENT (1938)
Solomon Fabricant 271 pp.

*36 THE STRUCTURE OF MANUFACTURING PRODUCTION, A CROSS-SECTION VIEW (1939)
C. A. Bliss 234 pp.

37 THE INTERNATIONAL GOLD STANDARD REINTERPRETED, 1914-1934 (1940)
William Adams Brown, Jr. 2 vols., 1,420 pp., $12.00

38 RESIDENTIAL REAL ESTATE, ITS ECONOMIC POSITION AS SHOWN BY VALUES, RENTS, FAMILY INCOMES, FINANCING, AND CONSTRUCTION, TOGETHER WITH ESTIMATES FOR ALL REAL ESTATE (1941)
D. L. Wickens 320 pp., 8¼×11¾, $3.50

39 THE OUTPUT OF MANUFACTURING INDUSTRIES, 1899-1937 (1940)
Solomon Fabricant 700 pp., $4.50

40 NATIONAL INCOME AND ITS COMPOSITION, 1919-1938 (1941)
Simon Kuznets 2 vols., 980 pp., $5.00

FINANCIAL RESEARCH PROGRAM

I A PROGRAM OF FINANCIAL RESEARCH

1 REPORT OF THE EXPLORATORY COMMITTEE ON FINANCIAL RESEARCH (1937)
91 pp., $1.00

2 INVENTORY OF CURRENT RESEARCH ON FINANCIAL PROBLEMS (1937)
253 pp., $1.50

• *Out of print.*

II STUDIES IN CONSUMER INSTALMENT FINANCING

1 PERSONAL FINANCE COMPANIES AND THEIR CREDIT PRACTICES (1940)
Ralph A. Young and *Associates* 170 pp., $2.00

2 SALES FINANCE COMPANIES AND THEIR CREDIT PRACTICES (1940)
Wilbur C. Plummer and *Ralph A. Young* 298 pp., $3.00

3 COMMERCIAL BANKS AND CONSUMER INSTALMENT CREDIT (1940)
John M. Chapman and *Associates* 318 pp., $3.00

4 INDUSTRIAL BANKING COMPANIES AND THEIR CREDIT PRACTICES (1940)
Raymond J. Saulnier 192 pp., $2.00

5 GOVERNMENT AGENCIES OF CONSUMER INSTALMENT CREDIT (1940)
Joseph D. Coppock 216 pp., $2.50

6 THE PATTERN OF CONSUMER DEBT, 1935-36 (1940)
Blanche Bernstein 238 pp., $2.50

7 THE VOLUME OF CONSUMER INSTALMENT CREDIT, 1929-38 (1940)
Duncan McC. Holthausen, in collaboration with *Malcolm L. Merriam* and *Rolf Nugent* 137 pp., $1.50

8 RISK ELEMENTS IN CONSUMER INSTALMENT FINANCING (1941)
David Durand 106 pp., $1.50; technical edition 163 pp., $2.00

9 CONSUMER INSTALMENT CREDIT AND ECONOMIC FLUCTUATIONS (1942)
Gottfried Haberler 239 pp., $2.50

III STUDIES IN BUSINESS FINANCING

1 TERM LENDING TO BUSINESS (1942)
Neil H. Jacoby and *Raymond J. Saulnier* 163 pp., $2.00

2 ACCOUNTS RECEIVABLE FINANCING (1942)
Raymond J. Saulnier and *Neil H. Jacoby* 157 pp., $2.00

3 FINANCING SMALL CORPORATIONS IN FIVE MANUFACTURING INDUSTRIES, 1926-36 (1942)
Charles L. Merwin 172 pp., $1.50

CONFERENCE ON RESEARCH IN INCOME AND WEALTH

STUDIES IN INCOME AND WEALTH
Volume I (1937) 368 pp., $2.50
*Volume II (1938) 342 pp.
Volume III (1939) 500 pp., $3.50
Volume IV—OUTLAY AND INCOME IN THE UNITED STATES, 1921-1938 (1942)
Harold Barger 376 pp., $2.50

CONFERENCE ON PRICE RESEARCH

1 REPORT OF THE COMMITTEE ON PRICES IN THE BITUMINOUS COAL INDUSTRY (1938) 144 pp., $1.25

2 TEXTILE MARKETS—THEIR STRUCTURE IN RELATION TO PRICE RESEARCH (1939) 304 pp., $3.00

3 PRICE RESEARCH IN THE STEEL AND PETROLEUM INDUSTRIES (1939) 224 pp., $2.00

CONFERENCE ON RESEARCH IN FISCAL POLICY

FISCAL PLANNING FOR TOTAL WAR (1942)
W. L. Crum, J. F. Fennelly, L. H. Seltzer 364 pp., $3.00

NATIONAL BUREAU OF ECONOMIC RESEARCH

1819 Broadway, New York, N. Y.

European Agent: Macmillan & Co., Ltd.
St. Martin's Street, London, W. C. 2

332
S85A
4225